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The Interpretation of Tax Legislation in Great Britain and Australia - A Study of the Indeterminacy of Law

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STATEMENT AS TO ORIGINALITY OF THESIS

This thesis is entirely my original work. However, chapter six is a revised version of two papers published in the *Melbourne University Law Review* and the *University of New South Wales Law Journal* respectively. With respect to those manuscripts, I received helpful comments from the referees. Notwithstanding these comments, I believe that the work represented by chapter six is my own.

Mark Burton
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ABSTRACT

The prevailing view of the history of tax interpretation is one of legal formalism. According to this account of judicial discovery and application of legislative rules, there is no room for judicial law making.

Chapter One introduces this mainstream account of tax interpretation over the last three centuries, noting the various permutations of this legal formalist account. The chapter also notes the significance of this account to liberal legal theory.

Chapters two, three, four and five examine the merits of the mainstream account in particular contexts. Chapter two examines the interpretation of tax legislation during the eighteenth and early nineteenth centuries, and argues that the evidence does not support the liberal legalist account of that history. It will be argued that the courts were only granted jurisdiction to hear a limited range of tax appeals in order to secure a tactical advantage for the central government in the administration of certain taxes. This tactical advantage was assured as, contrary to the prevailing account of tax history, the courts adopted a pro revenue construction of tax legislation until well into the nineteenth century.

Chapter three examines the interpretation of the income tax in the latter years of Victorian England - a statutory right of appeal against tax assessments only having been created in 1874. Although judges of this era occasionally referred to the rhetoric of strict or literal construction of tax legislation, it will be argued that the plethora of competing judicial views as to the proper understanding of fundamental elements of the income tax suggests that there was considerable confusion as to the scope of the income tax base. Whilst accepting that the existence of this confusion does not preclude the prospect of legal determinacy, it will be argued that a theory of law as rhetoric offers an appealing account of this judicial confusion. It will be argued that the competing interpretations of
the income tax are attributable to the competing understandings of the meaning of ‘income’ developed by different segments of the community in Victorian England. Thus the rhetoric of strict or literal construction of tax legislation (which was by no means the only interpretative rhetoric of the period) was of little importance in the actual interpretative process during this period because it ignored the competing interpretations of just what the ‘literal’ meaning of ‘income’ was.

It is generally accepted that during the twentieth century in both England and Australia the courts continued to adopt a literal interpretation of tax legislation until the 1980's. Taking up the interpretation of the Australian federal income tax which was introduced in 1915, it will be argued in chapter four that once again the application of a ‘literal’ meaning proved problematic to the courts. Focusing upon the statutory requirement that companies distribute to shareholders a minimum percentage of their profits (which effectively enforced the double taxation of corporate profits - firstly in the hands of the company and secondly in the hands of the shareholders), it will be argued that the courts sought to achieve some sense of equity by restricting the operation of the sufficient distribution requirement wherever possible. The means of achieving this understanding of tax equity was to adopt the ‘literal’ meaning of the provisions. The argument of chapter four is that, once again, the courts were confronted with competing interpretations of the proper application of the income tax, and that the liberal rhetoric of literal determinacy served an important function in legitimating the role of the courts in a manner consistent with the prevalent understanding of the rule of law.

Chapter five continues this appraisal of the mainstream account of tax interpretation by examining the interpretation of the Australian income tax in the years after the ‘tax avoidance crisis’ of the 1970's. In more recent times it is generally accepted that the courts have spurned the literalist cant of earlier generations of judges and moved towards a purposive construction of tax
legislation. This shift is judicial methodology is commonly perceived as a response to the perceived need for the judiciary to play a more pro-active role in combating the scourge of tax avoidance. In chapter five the merits of this account will be examined by considering recent High Court judgments upon the interpretation of the anti-avoidance provisions found in the *Income Tax Assessment Act 1936* (Cth).

In chapter six the theoretical shortcomings of the determinacy thesis will be examined, and an alternative theory of law as rhetoric will be proposed. While accepting that a theory of law as rhetoric cannot be proven as necessarily right, it will be argued that this alternative theory of law offers a plausible account for the development of legal doctrine, such that the predominance of liberal legal theory is called into question. Liberal legal theory, in other words, becomes just one of any number of competing interpretations of legal institutions, and a theoretically implausible one at that.

Chapter seven concludes the thesis by suggesting that the theory of law as rhetoric, developed in chapter six, is consistent with the case studies found in chapters two to five. It is therefore suggested that a theory of law as rhetoric offers a more substantial historiographical foundation to the account of tax interpretation since 1688 than the widespread acceptance of judicial descriptions of judicial practice. Chapter seven also includes a discussion of some of the more significant implications the implications for our understanding of the history of judicial tax interpretation and also for the Australian taxation system which arise out of the theory of indeterminate law advanced in chapter six.
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CHAPTER 1 - INTRODUCTION

A Overview

Modern commentators suggest that until the late 1970's the Australian courts adopted the long held practice of the British courts by interpreting tax legislation according to its strict literal meaning, resolving any ambiguity in favour of the taxpayer. However, in the 1970's the axiomatic status of this strict literalism was challenged upon the basis that it promoted tax avoidance and thereby threatened the integrity of the federal tax system and the foundations of the modern state. In response to this crisis of legitimacy it is generally accepted that the courts adopted an alternative interpretative methodology which focused upon discovering the legislative purpose of tax legislation.

According to this account of tax interpretation, both the literalist and purposive interpretative methodologies are alternative means for discovering the one 'right' meaning which is objectively 'there' within the legislative text. However, upon closer examination of the case law in Australia in the twentieth century, and the earlier British case law, it is apparent that this portrayal of tax interpretation creates a myth. Rather than being of ancient origin, it was only in the nineteenth century that the courts endorsed the rhetoric of a determinate, literal statutory meaning awaiting discovery. Moreover, even after the courts adopted this rhetoric, the judicial interpretation of tax legislation was far more pragmatic than the rhetoric of legal determinacy would suggest. At times the courts adopted the 'literal' meaning, at other times a 'technical' legal meaning, at other times the 'business or commercial' meaning, at other times the

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1 In the opening paragraphs I will sketch the subject of the thesis without referring the reader to the relevant literature. However, in the latter part of the introduction the relevant literature will be discussed in more detail. I will return to the literature, where relevant, throughout the thesis.
undesirable consequences of the literal meaning were considered to warrant an alternative interpretation and at yet other times the perceived purpose of the legislation was endorsed. There was always an array of authorised interpretative rhetorics which enabled the courts to appear to apply 'the' meaning of the statute while in fact choosing from among any number of plausible alternative interpretations. Rather than being constrained by 'the law', adjudication upon 'the law' was characterised by the judicial selection of the outcome which was most appealing from any one or more of a number of standpoints. While the existence of choice is a necessary part of the process of adjudication between competing interpretations, there is nothing in the judgments which suggests that such choices were necessarily determined by 'the law'.

Aside from exposing the historical inaccuracies which the mythical depiction of judicial tax interpretation perpetuates, a close examination of the tax case law therefore raises central jurisprudential issues which the myth has obscured. One of the keystones of modern legal theory, adopted by many tax commentators and the judiciary alike, is that the law is a formal system of objectively discoverable rules. According to this formalist account, determinate law created by democratically elected members of parliament and discovered and applied by neutral judicial arbiters is the hallmark of the modern Australian democratic system of government. However, a close examination of the tax cases suggests that judicial interpretation of tax legislation is pragmatic rather than formal, and it is therefore clear that this formalist theorisation of adjudication is inadequate. A theorisation of tax interpretation must therefore account for a judiciary which, over 150 years, has adopted the rhetoric of determinate law while engaging in a pragmatic interpretative enterprise. Further, any theorisation of pragmatic adjudication which rejects the prospect of 'one right answer' must consider the implications for the legitimation of the judicial function. Having thus outlined the subject and significance of the thesis, it is necessary to retrace our steps and develop some key aspects of the conventional account of tax interpretation.
Taxation law has attracted considerable attention in liberal political theory because a tax diminishes the very property rights of individuals which the modern liberal state was, at least in part, purportedly created to protect. The apparent contradiction of the state confiscating private property in order to protect private property has been rationalised in more recent times upon the consensual foundation of the modern democratic state - a community of individuals is taken to confer a mandate upon the democratically elected legislature to impose a tax for the benefit of the commonweal. It is for this reason that the seventeenth century revolution in English constitutional affairs, of which a significant feature was the extension of parliamentary control over what were formerly the Crown's arbitrary taxing powers, is considered a watershed in the formation of the modern state. Thereafter, a tax could only be

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2 John Locke, *The Second Treatise of Government*, JW Gough (ed), (1955) sec 124. Although it should be noted that the ideology of the welfare state may also be traced back at least to the eighteenth century; see, for example, Adam Smith, *An Inquiry into the Nature and causes of the Wealth of Nations*, W Todd (ed), (1976) Bk 2. For an alternative theorisation of liberal political theory, which deemphasised this fascination with rights, see: Judith Shklar, *Ordinary Voices* (1984); Judith Shklar, *The Faces of Injustice* (1990). Notwithstanding alternative theorisations of liberal theory such as Shklar's, the prevailing view of tax is that it diminishes private consumption in order to enhance public consumption; Richard Musgrave and Peggy Musgrave, *Public Finance in Theory and Practice* (1984) ch 1. For further discussion of the often competing ideologies with respect to the imposition of taxation see Louis Eisenstein, *Ideologies of Taxation* (1961).

3 For judicial recognition of the confiscatory nature of taxation see *Government of India v Taylor* [1955] AC 491.

4 Locke, above n 2, sec 138. Locke's enunciation of this rationalisation of taxation drew upon earlier expressions of this approach such as that of the *Petition of Right 1627* (Eng) 3 Car 1, c 1, s 1: 'Your subjects have inherited this freedom: that they should not be compelled to contribute to any taxe tallage ayd or other like charge not sett by comon consent in Parliament'. For earlier expressions of this principle see: the *Statute concerning Tallage 1297* (Eng) 25 Edw 1; the *Ship Money Act 1640* (Eng) 16 Car 1, c 14 and the *Bill of Rights 1688* (Eng) 1 Will & Mar Sess 2, c 2, s 1. For critical discussion of this principle see Richard Musgrave and Alan Peacock (eds), *Classics in the Theory of Public Finance* (1958) xv - xix; Richard Epstein, 'Taxation, Regulation and Confiscation' (1982) 20 Osgoode Hall Law Journal 433, 437.

5 See, for example, D Williams, 'Three Hundred Years On: Are our Tax Bills Right Yet?' (1989) 11 *British Tax Review* 370.
imposed under a statute which had been initiated by a majority of democratically elected members in the House of Commons.6

Implicit in this rationalisation of taxation within the liberal state is the liberal theorisation of the law and legal process which offers the assurance that 'the law' passed by the democratically elected Parliament is 'the law' that is ultimately imposed upon the subject.7 Proponents of the 'rule of law' freely acknowledge that the creation of statute law is inevitably a political process, but maintain that judicial adjudication upon determinate law is wholly segregated from any arbitrary influences.8 According to the model of formal justice9 underpinning this 'rule of law', the segregation of politics from law depends upon the ability of neutral arbiters to discover the determinate meaning of authorised legal texts.10 The determinate legal meaning is discovered by an

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6 Of course, any legislation also needed to pass the House of Lords and the Crown, but after 1688 only the House of Commons could initiate Bills proposing the imposition of a tax. The peculiar position of finance legislation is preserved in the Australian constitution, s 53 providing that tax measures may only be initiated by the House of Representatives which was originally considered to be 'the people's House'.


8 For a generic theory of liberal legalism see: Andrew Altman; *Critical Legal Studies: A Liberal Critique* (1990) 27; Neil MacCormick, 'Reconstruction after Deconstruction' (1990) 10 *Oxford Journal of Legal Studies* 539. HLA Hart is often categorised as a liberal legalist. However, to the extent that he is understood to suggest that in 'hard' cases judges will make law after considering a range of 'political' considerations such as the consequences and morality of the proposed rule, this lawmaking function of the judiciary may be inconsistent with a liberal theory of law; see HLA Hart, *The Concept of Law*, J Raz and PA Bulloch (eds), (first published 1961, 1994 ed). For further discussion of this point see Allan Hutchinson, 'A Postmodern's Hart: Taking Rules Sceptically' (1995) 58 *Modern Law Review* 788; Mark Burton, 'The Song Remains the Same - The Search for Interpretive Constraint and the Rhetoric of Legal Theory from Hart to Hutchinson' (1997) 20 *University of New South Wales Law Journal* 407.


10 The framing and status of the rules according to which a text becomes 'authorised' are the subject of considerable debate. For present purposes it is sufficient to note that, according to the
uncontroversial process which insulates the application of the law from the creation of law.\textsuperscript{11} This theorisation of the rule of law is commonly combined with legalism, which acknowledges the centrality of the courts in the enforcement of the law.\textsuperscript{12} Despite concerted attacks from the realist and critical legal studies ‘schools’,\textsuperscript{13} liberal legalism remains the dominant legal discourse in the Australian community.\textsuperscript{14}

There are two fundamental elements to the liberal legalist portrayal of legal interpretation. The first is the neutrality of the interpreters, and the second is the neutrality of the process by which determinate meaning is discovered. With respect to the first aspect, the courts are considered to be the appropriate vehicle

\textsuperscript{11} Altman, above n 8, 27.
\textsuperscript{12} For a critical elaboration of this understanding of the term ‘legalism’ see Harry Arthurs, ‘Without the Law’: Administrative Justice and Legal Pluralism in Nineteenth-Century England (1985). It should be noted that some authors use ‘legalism’ to denote a particular type of interpretative formalism; see, for example, Judith Shklar, Legalism (1964). For a non legalist theory of tax administration, see Yuri Grbich, ‘Operational Strategies for Improving Australian Tax Legislation’ (1990) 19 Federal Law Review 266; see also Edward L Rubin, ‘Law and Legislation in the Administrative State’ (1989) 89 Columbia Law Review 369.

\textsuperscript{13} Although it must be accepted that in Australia the realist and Critical Legal Studies critiques of mainstream legal theory were more subdued; notwithstanding the work of eminent scholars such as Julius Stone’s The Province and Function of Law (1961). The critical legal studies literature is immense, however for an overview of the fractured nature of critical legal studies see David Kairys (ed), The Politics of Law: A Progressive Critique (1982); Alan Hunt, ‘The Theory of Critical Legal Studies’ (1986) 6 Oxford Journal Legal Studies 1; Allan Hutchinson and Patrick Monahan ‘Law, Politics and the Critical Legal Scholars: The Unfolding Drama of American Legal Thought’ (1984) 36 Stanford Law Review 199; Roberto Unger, The Critical Legal Studies Movement (1986). There has been substantial debate as to whether the critical legal studies critique of ‘liberal legal theory’ is in fact based upon misinterpretations of the work of several quite different liberal legalists; see, for example, William Ewald, ‘Unger’s Philosophy: A Critical Legal Study’ (1987-88) 97 Yale Law Journal 665; Martin Krygier, ‘Critical Legal Studies and Social Theory - A Response to Alan Hunt’ (1987) 7 Oxford Journal Legal Studies 26, 28.

\textsuperscript{14} Robert Gordon, ‘Critical Legal Histories’ (1984) 36 Stanford Law Review 57, 58-9 n 8. Of course, speaking of a theory of liberal legalism is an oversimplification as ‘liberal legalism’ describes a range of theories which offer variations upon several themes. Further, any ‘liberal’ legal theory focuses upon certain aspects of a liberal worldview while implicitly assuming many other aspects of that worldview. However, having acknowledged the inevitable shortcomings of any thumbnail sketch of such a polymorphous theory, for the purposes of this thesis a liberal theory of law maintains that the rights of the individual as against the state and other individuals are governed by the rule of determinate law.
for rational adjudication upon legal rights because it is judicial impartiality which is the vital condition of possibility for rational judgment uninfluenced by 'political' considerations.\(^{15}\) In regard to the second aspect, the neutral discovery of determinate meaning is possible because legal texts are perceived as univocal in all cases.\(^ {16}\) In the absence of a univocal legal text, the methodical judicial application of determinate law would be displaced by the perceived 'nightmare'\(^ {17}\) of indeterminate legal texts which would compel judges to pragmatically make 'law' in every case. The determinacy of the law is therefore the keystone underpinning what are commonly taken to be the fundamental constitutional principles of modern Anglo-Australian law - the rule of law and the separation of the judicial power from the political power of government.\(^ {18}\)

The determinacy thesis is at least superficially attractive for a number of reasons.\(^ {19}\) One view suggests that the rule of determinate law is a necessary, but not sufficient, condition to the fulfilment of liberal values centring upon individual autonomy.\(^ {20}\) Determinate law enables individuals to plan their affairs, knowing that they are acting within the confines of the law and are therefore legally free from successful state or private intervention.\(^ {21}\) This

\(^{15}\) Walker, above n 7, 36-40.

\(^{16}\) See, for example, Andrew Altman, Critical Legal Studies: A Liberal Critique (1990) 27; Hart, above n 8, 124, where Hart argues that meaning is generally conventionally determined from the outset, penumbral cases aside; Lon Fuller, The Morality of Law (rev edn, 1969) ch 2; Ronald Dworkin, Law's Empire (1986) viii-ix, 76-86.


\(^{18}\) Walker, above n 7, 3.

\(^{19}\) Although the determinacy thesis has thus far been portrayed as a part of a liberal legal theory, it should also be noted that many who would not necessarily describe themselves as liberals either subscribe to the normative vision of determinate law or at least acknowledge the normative appeal of determinate law; see, for example, Martha Minow, 'Interpreting rights: an essay for Robert Cover' (1987) 96 Yale Law Journal 1860, 1910; E P Thompson, Whigs and Hunters: The Origin of the Black Act (1975) 258-269.


\(^{21}\) See John Locke, above n 2, para 137; John Rawls, A Theory of Justice (1971) 239-40; TRS Allan, 'Legislative Supremacy and the Rule of Law: Democracy and Constitutionalism', above n
rationale for legal determinacy suggests that, for a legal rule to be 'determinate', the meaning must be fixed from the inception of the rule. Under this rationale a liberal legalist cannot accept a theory of interpretation which acknowledges that legal meanings may change over time, even if the law is determinate at any particular time, because such ephemeral meaning is of no use to a citizen wishing to arrange their affairs upon the basis that legal meaning will remain constant. This requirement for certainty in the future application of legal rules may be called 'prospective determinacy'.

A second rationale for legal determinacy emphasises the need to protect the individual from arbitrary decisionmaking by the administrative and judicial arms of government. By contrast to the first rationale of legal determinacy, this rationale can accommodate a theory of interpretation which acknowledges that meaning may change over time, but nevertheless requires that meaning is determinate at the time the law is applied to the circumstances of a particular case. This might arise, for example, if it is accepted within a community that the ordinary meaning of a term differs to what it used to mean. Under this theory of interpretation, a judge must identify the nature of the community consensus upon the meaning of a particular legal rule at the time that it is to be applied. The ascertainment of legal meaning is therefore not left to the subjective whim of a judge, as some realist and critical legal scholars suggest, but is in some way 'discovered' by the judge. This approach could be called

7, 118; Neil MacCormick, 'The Ethics of Legalism' (1989) 2 Ratio Juris 184, 184. In the context of taxation law see, for example, Robin Speed, 'The High Court and Part IVA' (1986) Australian Tax Review 156, 157; Daniel Sandler, A Request for Rulings (1994). The perfect operation of the rule of law depends, of course, upon enforcement mechanisms being adequate such that the law is followed or enforced in all cases.

22 For the origins of the separation of powers doctrine see W Holdsworth, A History of English Law (1964) vol 10, 255-6.

23 See, for example, the dissenting judgment of McTiernan and Jacobs JJ in A-G (Cth) ex rel McKinlay v The Commonwealth (1975) 135 CLR 1, 36.

one of retrospective determinacy because the determinate legal meaning is only established at the time of judgment and operates retrospectively with respect to the affairs of the person subject to the law.  

Aside from these normative justifications of the determinacy thesis, it is also generally accepted that it offers an accurate description of the judicial interpretation of legislation. The starting point of this descriptive account of legal determinacy is the emergence of a more independent, tenured judiciary after the constitutional revolution in seventeenth century England. With this condition of possibility for independent adjudication seemingly assured, it is generally assumed that the English courts reconsidered their function in light of the rhetoric of individual rights of the new liberal political order. Accordingly, after 1688 the courts adopted a more robust understanding of their role in guarding the 'legal' rights of individuals against arbitrary interference by the state. The courts therefore enforced 'the law', which was conceived as a more or less objectively identifiable body of rules with determinate meaning. In the context of the interpretation of tax legislation, it is generally accepted that

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26 See, for example, R Cross, Statutory Interpretation, J Bell and G Engle (eds), (1987), ch 1; DC Pearce and RS Geddes, Statutory Interpretation (4th ed, 1996) ch 9; see also the historical account of SE Thorne in his introduction to Sir T Egerton, A Discourse Upon the Exposicion and understandinge of statutes with Sir Thomas Egerton's Additions S Thorne (ed) (1942) 84; W Windeyer, Lectures on Legal History (2nd ed, 1957) ch 30; JA Corry, 'Administrative Law and the Interpretation of Statutes' (1935) 1 University of Toronto Law Journal 286.

27 Originally judges had held office at the pleasure of the Crown, but in 1701 many of the elements of modern judicial independence were promulgated in the Act of Settlement 1701 (Eng) 12 & 13 Will 3, c 2, s 3. However, under (1701) 6 Anne, c 7 (Eng) (An Act for the security of her Majesties person), s 8 judges and other nominated officers of the Crown retained office for six months after the death of the monarch. Life tenure for judges was only adopted in 1760 with the passing of I Geo III c 23 (An Act for the further Limitation of the Crown ...) (UK).

28 For discussion of the emergence of judicial independence in the eighteenth century and its impact upon the process of judging see Holdsworth, above n 22, vol 10, 647; Walker, above n 7, ch 3.
the method of discovering the determinate meaning of tax legislation has passed through at least two distinct phases over the course of the last three centuries.

1 The Literal Meaning

The reconsideration of the judicial role in the new constitutional epoch is generally considered to have precipitated a greater willingness on the part of the judiciary to focus upon the literal meaning of legislation, as opposed to adopting an 'equitable' or purposive construction of legislation. In the context of tax law, the courts purportedly embraced legal formalism by categorising tax legislation as 'penal', upon the basis that the imposition of a tax compelled the transfer of private property to the state. In order to protect the rights of the individual from such 'penal' legislation, the eighteenth century English courts purportedly adopted the rule that tax legislation must be interpreted strictly against the Crown. This meant that the courts would adopt a literal

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30 For the early recognition of this approach on the part of the commentators see, for example, F Dwarris, A General Treatise on Statutes (1848) vol 2, 646; W Benning, A General Treatise on Statutes: Their Rules of Construction (2nd ed, 1848) Pt 1, 646-7.

interpretation of tax legislation, but in the event of any ambiguity, the ambiguity would generally be resolved in favour of the taxpayer. 32 Within this broad framework there are a number of differences between the commentators. Some suggest that the strict construction rule was replaced by the general literal rule in the nineteenth century, 33 while others suggest that the strict construction rule survives to the present day. 34 Moreover, some commentators have questioned the differentiation between the literal rule and the strict construction rule, suggesting that the courts in any event focus upon ascertaining the meaning of the legislation. 35 At the least, it seems to be generally accepted that some form of the literal rule of interpretation underpinned the judicial interpretation of tax legislation until relatively recently. Indeed, even at the time of writing some judges continued to refer to the literal meaning of tax legislation in arriving at their respective decisions. 36

The concept of literal meaning has been understood from the perspective of both of the rationales of legal determinacy outlined above. According to the 'literalist' version of the determinacy thesis, the meaning of statutory words is determined according to the acontextual meaning of the words found in the statute. This theorisation of legal determinacy draws upon analytic theories of language, which focus upon identifying the necessary conditions before a statement will be true. According to such analytic theories of language, any

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33 See, for example, AG v Sillem (1864) 2 H & C 431, 509.
36 Thus, for example, in Consolidated Press Holdings v FCT 98 ATC 5009 Hill J suggested that it was the function of the courts to ascertain the legislative purpose by considering the meaning of the words used in the legislation (at 5,017). For further discussion of this approach to statutory interpretation see DG Hill, 'A Judicial Perspective on Tax Law Reform' (1998) 72 Australian Law Journal 685.
statement can be dissected into its truth conditions. Applying these theories to the statutory context, they would suggest that the meaning of any statutory rule is objectively ‘there’ within the rule itself. Accordingly, the judge objectively ascertains the objective meaning of the relevant statutory words. One reason for the survival of this literalist theory is that it can accommodate both prospective and retrospective rationalisations of the determinacy thesis. To those endorsing the prospective understanding of determinacy, the courts should follow the meaning of the words in existence at the time the Act of Parliament is made. On the other hand, those who adhere to the rationalisation of legal determinacy in terms of retrospective determinacy maintain that the courts should adopt the meaning of the Act of Parliament in existence at the time of the judgment and that meaning need not necessarily be the same as the meaning when it was created. Under this view, any change in the literal meaning of a statutory term is effected by a communal consensus rather than by the unilateral action of a judge. According to either account, then, statutes embody clear law passed by a democratically elected Parliament which are mechanically applied by neutral arbiters.

2 The Purposive Construction of Tax Legislation

Towards the end of the 1970’s the literalist methodology was subjected to considerable criticism. The perceived shortcoming of literalism was that it

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37 Allan, Legislative Supremacy, above n 7, 117, 118; Dworkin, Law’s Empire, above n 16, 17. This approach to statutory meaning was also adopted by Hart at some points in his work; see Hart, above n 8, 127-8.
38 This prospective determinacy appears to underpin a number of tax judgments. See, for example, Amalgamated Society of Engineers v Adelaide Steamship Co Ltd (1920) 28 CLR 129, 161-2, (Higgins J); Federal Commissioner of Taxation v Westraders Pty Ltd (1980) 144 CLR 55, 59-60 (Barwick CJ); Heppes v FCT 91 ATC 4808, 4818-19 (Deane J).
39 This may be the approach adopted by Oliver Wendell Holmes; see Oliver Wendell Holmes, ‘The Theory of Legal Interpretation’ (1899) 12 Harvard Law Review 417, 419-20; A-G (Cth) ex rel McKinlay v The Commonwealth above note 23, 36 (McTiernan and Jacobs JJ).
emphasised the *word* and ignored the *intention* underlying the word.\(^40\) Although it was generally accepted that there was a literal meaning of any text, intentionalist theories of meaning suggest that language is an imperfect medium for the communication of ideas and so the legislature does not necessarily say what it means. Advocates of a purposive construction therefore propose that the intention or purpose ‘behind the legislative words’ ought be paramount.\(^41\) In the context of tax interpretation, literalism was considered to be evidence of a judicial willingness to lend undue assistance to taxpayers by upholding tax avoidance arrangements which subverted the underlying legislative intention.\(^42\) The application of the strict construction rule is therefore commonly blamed for precipitating a crisis of legitimacy within the Australian legal system in the 1970’s which was perceived as a threat to the integrity of the Australian taxation system\(^43\) and also as a threat to the public respect for the Australian legal system. In response to this crisis there was a widespread reexamination of the assumptions underpinning the literalist methodology and a marked shift to a purposive interpretative rhetoric. This purposive method was considered especially appropriate in the context of statutory provisions designed to reduce


\(^{41}\) Walker above n 7, 172; Allan above n 7, 139.


tax avoidance, although it is now generally accepted that the courts adopt an intentionalist method with respect to all legislation.

This purposive theory of interpretation has been understood in various ways, which once again are more or less consistent with the alternative rationalisations of legal determinacy outlined above. For example, one approach suggests that the law comprises only those matters which were, or could reasonably have been, within the contemplation of the legislature at the time that the relevant statute was made. In the context of the income tax, for example, it might be argued that the profit under a sophisticated interest rate swap agreement could not possibly have been within the contemplation of the Parliament in 1936 when the earlier version of the income tax was introduced, and therefore that such profits could not comprise income for the purposes of that legislation. This version of purposive theory achieves a happy medium between the poles of flexibility and constraint. The scope of the legislation is in one sense determinate because 'the law' is the hypothetical answer of the enacting Parliament to the hypothetical question, while at the same time the 'purpose' of the legislation can be adapted to new developments in the social world.

An alternative version of purposive theory suggests that the 'intention' of the statute includes those matters which the legislature making the law would have
included if they had been specifically asked. Under this view, it might be argued that the assessability of a profit under an interest rate swap agreement would depend upon the answer to the hypothetical question asked of the 1936 Commonwealth Parliament 'would you have included this profit in assessable income?' This version of purposive theory accepts that legislative meaning changes over time, as the hypothetical question would be answered having regard to the original legislative purpose understood in the particular context at the time the legislation was interpreted.

Once again, all of the variations of purposive theory have the perceived merit that the judge is considered to play a 'passive' role in merely discovering the legislative purpose evidenced by the legislative text and, perhaps, the authorised 'extrinsic' materials.

3 Hermeneutic Theories of Legal Determinacy

More recently some eminent current and retired judges have expressed their dissatisfaction with the view that judges merely discover the literal meaning of legislation or the legislative purpose. These judges and other commentators argue that judges must have recourse to fundamental communal moral norms in 'making' law in some sense.49 This assertion of judicial activism may be considered to be anathema to the liberal legalist theorisation of law outlined above. However, a closer reading of these discussions of judicial 'lawmaking' suggests that such endorsements of 'judicial activism' may not represent the radical departure from literalism or purposive interpretation that they seem to

48 This, of course, raises all sorts of additional issues, such as whether legislation which has been repeatedly amended without specific reference to such receipts implicitly includes those receipts within the tax net or not.
propound. On one view, such hermeneutic theories of judicial activism may merely emphasise the objectivism of literalism or intentionalism:

In the case of statutes which impinge upon fundamental values, it is possible to say that an unambiguous and unmistakeable expression of intention is required to justify an interpretation which trenches upon the values. To insist upon the expression of such an intention is to enhance the legislative process by compelling those who introduce legislation to make plain to the legislature what the effect of the legislation will be.50

However, even if this legal hermeneutics does not lead one back to literalism or purposive interpretation, proponents of this ‘activism’ acknowledge that judges do not make law according to their own subjective standards of justice.51 Rather, it is suggested that there is always a ‘right’ answer to a legal question, that right answer being determined by recourse to the moral and political norms of a particular community.52 This theory may be consistent with both of the rationalisations of legal determinacy outlined above,53 or alternatively may merely accord with the second rationale of retrospective determinacy.


51 This reconsideration of the judicial function, and in particular the consideration of the extent to which judges can be said to ‘make’ law, repeats the more fully reasoned examination of this issue in the debates between HLA Hart and Ronald Dworkin.


53 Ronald Dworkin, for example, maintains that the courts interpret preexisting principles of the law in a manner which satisfies the requirement of prospective determinacy whilst
The fact that there are now literalist, purposive and hermeneutic accounts purporting to describe the process of tax interpretation indicates that there is no longer the consensus upon the interpretative axioms that there perhaps was at one time in the legal community. The profession and academy have fractured into a number of schools offering competing theories of legislative determinacy in the context of taxation law. The key point of contention between each of these rival accounts of legal determinacy is the extent to which what is perceived to be the potentially disruptive social context of the legislation is recognised as an influence upon the outcome of the interpretative process. Determinacy theorists are mindful of what they consider to be the nightmarish world depicted in deconstructive writing – one of the key elements of deconstructive theory being that one cannot help but incorporate the context of a text in attributing meaning, and that by thus admitting context we are drawn into the continual slippage of meaning in a process which defies the closure of determinate meaning.

From the preceding outline of alternative accounts of the determinacy thesis, it may be seen that these accounts either limit the relevance of the social context of the text and the interpretative act or exclude any role for this context altogether. Under a strict literal rule framed in accordance with the precepts of prospective determinacy, the acontextual ascertainment of acontextual legal meanings elides any judicial reference to the social and legislative context in which the legislation is being applied. By contrast, a literalist account framed in terms of retrospective determinacy clearly incorporates a role for the context of the text in the process of interpretation, as it requires the judge to determine the meaning of statutory words for her or his community at the time that the

simultaneously recognising that legal principles may be interpreted in light of changing social conditions; Dworkin, above n 16.

54 Altman, above n 8.
legislation is to be applied. A purposive theory may also allow reference to a prescribed range of ‘authorised’ contextual materials in establishing the legislative intention.\textsuperscript{55} Alternatively, and depending upon the breadth with which the legislative intention is stated, reference to the legislative intention could be understood to require an appreciation of the broad social context in which the legislation is to be applied. For example, if the legislative intention is understood to be the creation of a ‘just’ legal system,\textsuperscript{56} it would seem that the judge could quite legitimately construct a theory of justice in accordance with communal morality and interpret the legislation in a manner which was considered to further the dictates of that scheme of justice. Under this ‘broad’ version of purposive theory, in a practical sense there would be little difference between a purposive theory and a hermeneutic theory of interpretation. According to hermeneutic theory, any legislation forms just one part of the social context which the judge must interpret as a whole in identifying the ‘right’ legislative meaning. Hermeneutic theories of meaning may therefore admit a role for the social and moral context of a text in the ascertainment of meaning, but it is a sanitised understanding of context founded upon the assumption of coherence.

\textbf{D The Path Ahead}

All theories of legal determinacy therefore regulate the potentially disruptive influence of the statutory context, by eliminating recourse to context altogether or admitting only a coherent social or moral context past the portals of the courts. The plurality of context depicted by some deconstructive writing is, therefore, nowhere to be seen. The recognition of context and the determination of its role within a theory of tax interpretation is therefore not an idle


\textsuperscript{56} M Radin, ‘Statutory Interpretation’ (1930) 43 Harvard Law Review 863, 877.
philosophical question of the 'how many angels can dance on the head of a pin' kind. The prospect of a legal system founded upon indeterminate legal texts and judicial lawmaking (in a more radical sense than that contemplated within hermeneutic theory) threatens the very foundations of liberal legal theory. The central question of this thesis, then, is whether the contemporary adherence to formal theories of law in both descriptive and normative terms is a case of wishful thinking.

The first task of this thesis is therefore to examine the judicial interpretation of tax legislation in the United Kingdom since 1689, and in Australia after 1900, in order to determine whether the formalist account of tax interpretation is convincing. Over the past 300 years there have been thousands of tax cases involving a wide range of taxes. A comprehensive appraisal of the applicability of the determinacy thesis to each of these cases is clearly impossible within the limits of this thesis. It is therefore necessary to restrict the historical account of the judicial interpretation of tax legislation by undertaking a number of case studies which focus upon the judicial interpretation of tax legislation in several historical periods. To this end, the judicial interpretation of the window tax in the eighteenth century, the interpretation of the income tax in the United Kingdom in the nineteenth century, and the interpretation of the income tax in Australia in the twentieth century, have been selected as appropriate subjects for the purposes of this thesis. The justification for examining the judicial interpretation of each of these taxes will be considered at the beginning of each case study.
CHAPTER TWO: RECONCILING THE RHETORIC OF RIGHTS WITH THE PRO REVENUE CONSTRUCTION OF TAX LEGISLATION IN EIGHTEENTH CENTURY ENGLAND

A Introduction

In chapter one it was noted that the generally accepted account of early tax interpretation suggests that tax legislation was categorised by the courts as 'penal' because the imposition of a tax was perceived to compel the transfer of private property to the state. In order to protect the rights of the individual from such penal legislation, it is generally assumed, the eighteenth century English courts adopted the rule that tax legislation must be interpreted strictly against the crown. The purpose of this chapter is to consider whether this formalist account of early tax interpretation is convincing. Of course, a comprehensive analysis of the interpretation of taxation legislation in the eighteenth and nineteenth centuries is beyond the scope of this chapter. However, the hitherto unexamined judicial interpretation of the window tax will be considered in appraising the merits of the formalist account of early tax interpretation.

Although relatively small in terms of its revenue yield, the window tax is an ideal object of study for the purposes of examining tax interpretation after the constitutional revolution of 1688. First introduced in 1696, the window tax was a product of what was, at least in theory, the new constitutional epoch in

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1 A peripheral aspect of Ward's works upon the administration of the window tax was some consideration of the administrative interpretation of the window tax, but he did not include the judicial interpretation of the window tax within the scope of his study; see: W Ward, The administration of the window and assessed taxes 1696-1798 (1963); W Ward, 'The administration of the window and assessed taxes 1696-1798' (1952) 67 English Historical Review 522.

2 For the ascendancy of the indirect taxes over the direct taxes including the window tax and land tax, see: P Mathias and P O'Brien, 'Taxation in Britain and France, 1715 -1810' (1976) 5 Journal of European Economic History 601.

3 (1696) 7 & 8 Will & M, c 18 (An Act for granting to His Majesty several Rates or Duties ...) (Eng).
which the crown had ceded control over taxation to Parliament. Given that the introduction of the window tax coincided with the emergence of judicial independence after the Act of Settlement 1701, the interpretation of the window tax was not governed by earlier judicial interpretations adopted in the time of the theoretical, and more or less practical, monarchic control of the central government. Further, given the recent success of the Glorious Revolution in securing parliamentary control over the imposition of taxation, the interpretation of the window tax was undertaken in the epoch when the rhetoric of individual property rights was in its ascendancy. Introduced in the new era of parliamentary control, and interpreted by independent judges purportedly imbued with the ideology of liberal property rights, one would be hard pressed to find a tax which was more likely to have been interpreted according to a formalist methodology. As such, the window tax represents an ideal subject for testing the formalist accounts of tax interpretation in eighteenth century England.

There are also more practical reasons for examining the interpretation of the window tax. Without embarking upon a detailed history of taxation in the United Kingdom it is sufficient for present purposes to note that the principal

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4 It is generally recognised that while 1688 was a milestone on the path to a constitutional monarchy, it by no means cemented the authority of parliament over the powers of the monarch. For discussion of this in relation to the tax power see: Margaret Levi, *Of Rule and Revenue* (1988) 127-32.

5 For further discussion of this aspect see text accompanying nn 172-180 below.

6 While it is clear that the doctrine of precedent was in its infancy, even in the absence of such a doctrine it would be reasonable to expect that, had there been earlier decisions upon the window tax, the courts would have regard to the tenor of those decisions in adjudicating upon subsequent cases. For discussion of earlier use of precedents see: W Prest, 'The Dialectical Origins of Finch's Law' (1977) *Cambridge Law Journal* 326; BJ Shapiro, 'Law and Science in Seventeenth Century England' (1969) 21 *Stanford Law Review* 727.


forms of taxation imposed by the central government in the late seventeenth century were customs duties, excise duties and various forms of direct taxes. The principal forms of direct taxes in this era were the so called land tax of 1688, the window tax of 1696 and the sporadic poll tax. As the window tax was one of the few taxes for which there was a statutory right of appeal to the courts in the eighteenth century, there are only a small number of case reports regarding the substantive provisions of eighteenth century tax legislation, of which the window tax cases form a significant part.

Further, unlike many other taxes of relatively short duration, the window tax survived for over 150 years, and therefore provides a picture of the early interpretation of tax legislation over a considerable period. The longevity of the window tax, and its 'visibility' arising from its direct nature, also meant that it was of sufficient importance upon the social landscape to generate a document trail in the form of legislative amendments, reported judicial decisions, administrative papers and social commentary upon the tax. The 'footprint' of the window tax upon the pages of history is therefore of sufficient size to enable the development of an account of its interpretation.

Note that the local administration also imposed a range of taxes for the purposes of funding specific projects such as roads, bridges and poorhouses.

Note that the hearth tax of (1662) 3 & 4 Car II, c 10 (An Act for Establishing an additional Revenue upon his Majesty...) (Eng) was repealed by (1688) 1 Will & M, c 10 (An Act for Taking away the Revenue arising ...) (Eng).

(1688) 1 Will & M, c 20 (An Act for a Grant to their Majesties of an Aid...) (Eng). Although the statute also imposed a tax upon personal property and some forms of income, the administration of the tax failed to enforce the tax on personal property and income, and so the tax was in practice a tax upon land.

See above n 3.

See, for example, (1690) 2 Will & M, Sess 1, c 2 (An Act for raising Money by a Poll) (Eng).

Although there are many decisions regarding the failure of tax collectors to remit collected taxes to the central government.

For example, the hearth tax, noted above at n 10. Towards the close of the eighteenth century a number of taxes upon indicia of wealth such as servants, silverplate and carriages were imposed but were of relatively short duration.

The window tax was repealed by (1851) 14 & 15 Vict, c 36 (An Act to repeal the Duties payable on Dwelling Houses ...) (Eng).
B Legislative History of the Window Tax - An Overview

As already noted, the window tax was introduced in 1696 for an initial term of seven years\textsuperscript{17} with the stated object of recouping losses arising from the wear and clipping of the currency.\textsuperscript{18} Although it had been amended with some regularity,\textsuperscript{19} the original window tax was repealed and replaced with a revised window tax in 1748.\textsuperscript{20} This revised version was repeatedly amended until its repeal and replacement in 1765.\textsuperscript{21} The window tax was subsequently repealed and replaced in 1784,\textsuperscript{22} 1798,\textsuperscript{23} 1803,\textsuperscript{24} and 1808.\textsuperscript{25} The window tax was finally repealed in 1851\textsuperscript{26} as the seemingly insurmountable shortcomings of the tax precipitated its demise.\textsuperscript{27}

There were at least two significant features of the window tax legislation over the course of its 150 year life. The first was that the window tax was expressed in broad terms, being imposed upon the occupier of each ‘inhabited dwelling

\textsuperscript{17} This was subsequently extended by (1697) 8 & 9 Will, c 20, s 15 (An Act for making good the Deficiencies of several Funds ... ) (Eng) and (1701) 1 Anne, Sess 1, c 13 (An Act for making good Deficiencies...) (Eng), and was made perpetual by (1706) 5 Anne, c 13 (An Act for continuing the Duties upon Houses ...) (Eng).

\textsuperscript{18} Treasury had expressed concern regarding the debasement of the currency in 1695; see, for example, W Shaw (ed), Calendar of Treasury Books (1969), vol 10, 1144-7, 1385, 1396-7.

\textsuperscript{19} For the legislative history of the window tax from 1696 see: (1696) 7 & 8 Will & M, c 18; (1697) 8 & 9 Will, c 20; (1701) 1 Anne, Sess 1, c 13; (1706) 5 Anne, c 13; (1709) 8 Anne, c 4 (An Act for continuing Part of the Duties ...) (Eng); (1716) 3 Geo I, c 8, s 17; (1718) 5 Geo I, c 3, s 22; (1718) 5 Geo I, c 19; (1719) 6 Geo I, c 21, s 61; (1747) 20 Geo II, c 3 (An Act for repealing the several Rates and Duties upon Houses, Windows and Lights ...) (Eng); (1747) 20 Geo II, c 42 (An Act to enforce the Execution of an Act of this Session of Parliament ...) (Eng).

\textsuperscript{20} (1747) 20 Geo II, c 3 (An Act for repealing the several Rates and Duties upon Houses, Windows and Lights ...) (Eng).

\textsuperscript{21} (1766) 6 Geo III, c 38, s 1 (An Act for repealing the several Duties upon Houses, Windows, and Lights ...) (Eng).

\textsuperscript{22} (1784) 24 Geo III, c 38 (An Act for repealing several Duties on Tea ...) (Eng).

\textsuperscript{23} (1798 38 Geo III, c 40 (An Act for repealing the Duties on Houses, Windows, and Lights...) (Eng).

\textsuperscript{24} (1803) 43 Geo III, c 161, s 84 (An Act for repealing the several Duties under the Management of the Commissioners for the Affairs of Taxes ...) (Eng).

\textsuperscript{25} (1808) 48 Geo III, c 55 (An Act for repealing the Duties of Assessed Taxes ...) (Eng).

\textsuperscript{26} (1851) 14 & 15 Vict, c 36.

\textsuperscript{27} Some attention to the deleterious consequences for public health arising from the window tax may be found in the pamphlet literature. See, for example, Anon, Suggestions for the Repeal of the Assessed Taxes and the substitution of an equitable property and income tax (1848) 3.
"house" with respect to the number of windows in such buildings.\textsuperscript{28} There was no statutory definition of these key elements of the window tax base, such matters being left to the tax administration to resolve. Indeed, the window tax typified the brevity of the legislation of the period, there being just a handful of specific provisions dealing with particular circumstances.\textsuperscript{29}

The second feature of the legislation is the repeated revision of the window tax legislation over its one hundred and fifty five year life. The legislature introduced a host of amendments to the window tax base as the perceived need to cater for an increasing number of ‘special’ cases arose. The mainstream account of the changing tax legislation of this period suggests that the trend towards the detailed elaboration of the tax base is to be explained by the need to shore up the tax base against the strict construction of ‘penal’ tax legislation by the judiciary.\textsuperscript{30} This is only a part of the truth. Certainly, there were amendments to the legislation which attempted to shore up the window tax base. Thus, for example, in 1747 it had come to light that taxpayers were evading the tax by blocking windows in anticipation of the assessor’s inspection and subsequently reopening them. To overcome this practice, an anti avoidance provision imposing a penalty for such evasion was inserted into the Act.\textsuperscript{31} However, in an apparent contradiction of the perceived trend to the detailed statutory elaboration of the tax base, throughout the life of the window tax the

\begin{itemize}
\item \textsuperscript{28} Thus, for example, even in 1798 the legislature continued to impose liability to the tax with respect to the windows or lights of inhabited houses without any further elaboration upon the meaning of these terms; see (1798) 38 Geo III, c 40 (An Act for repealing the Duties on Houses, Windows, and Lights, on Inhabited Houses ...) (Eng) s 2.
\item \textsuperscript{29} The main category of exemption was for houses exempt from the poor rate. Note that the exemption of those excluded from the poor rate underwent some development. According to (1747) 20 Geo II, c 3 (An Act for repealing the several Rates and Duties upon Houses, Windows and Lights...) (Eng), s 29 the inhabitant of the house had to be exempt from the church and poor rates and the house had to be a cottage with 9 windows or less. In (1784) 24 Geo III, c 38, s 18 the exemption was extended by the removal of the second requirement.
\item \textsuperscript{30} See, for example, JA Corry, ‘Administrative Law and the Interpretation of Statutes’ (1935) 1 University of Toronto Law Journal 286. Corry suggests that the eighteenth century is marked by a shift to increasingly detailed legislation.
\end{itemize}
core elements of the window tax were never specifically defined by the legislature. 'Inhabited dwelling house' and 'window' were supposedly left to the perils of strict judicial interpretation. Further, far from the legislature having to create increasingly detailed legislation to shore up the tax base, a review of the amendments to the window tax suggests that a large number of the reforms to the window tax had the opposite effect of exempting various taxpayers from liability. Thus, for example, the dairy industry secured the exemption of windows in dairies and cheese rooms, while in the early nineteenth century other specific exemptions were granted with respect to rooms used for licensed chapels, rooms used for carrying on manufacture, mills or places of manufacture guarded by a resident employee, rooms used by professional persons and unfurnished houses in the care of a servant.

The absence of any concerted attempt on the part of the legislature to comprehensively define the window tax base, and indeed the substantial number of specific exempting provisions amongst the legislative amendments to the window tax legislation, are the first clues which suggest that the generally accepted account of tax interpretation may be somewhat inaccurate. Had the courts been strictly interpreting the window tax legislation against the Crown, consistent with the generally accepted account of tax interpretation, it might

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31 (1747) 20 Geo II, c 3 (An Act for repealing the several Rates and Duties upon Houses, Windows and Lights ...) (Eng), s 39.
32 (1796) 36 Geo III c 117 (An Act to exempt certain windows) (Eng). For discussion of this amendment see: A Haldane (Lord Duncan), A Speech delivered in the House of Commons on Thursday February 24 1848 on a motion for leave to bring in a bill for the repeal of the window-tax (1848) 15.
33 (1802) 42 Geo III, c 34 (An Act for granting to his Majesty certain additional Duties on Windows...) (Eng), s 10.
34 (1810) 50 Geo III, c 104 (An Act for altering the Amount of certain Duties of Assessed Taxes ...) (Eng), s 8.
35 (1817) 57 Geo III, c 25 (An Act to explain and amend an Act, ... for repealing the Duties of Assessed Taxes...) (Eng), s 4.
36 (1824) 5 Geo IV, c 44 (An Act for allowing Persons to compound for their Assessed Taxes ...) (Eng), s 4.
37 (1825) 6 Geo IV, c 7 (An Act for the further Repeal of certain Duties of Assessed Taxes ...) (Eng), s 3.
have been expected that the government of the day would have done its utmost to protect the revenue by enacting increasingly detailed definitions of the key elements of the window tax base. The fact that the legislature did not concern itself with even the most rudimentary definition of 'window' or 'inhabited house', while enacting a steady stream of specific exemptions from the tax base, therefore seems contrary to what might have been expected had the generally accepted account of tax interpretation been accurate. To unravel this mystery it is therefore necessary to consider the elements of the generally accepted account of tax interpretation. The starting point for this inquiry is to consider whether taxation in general, and the window tax in particular, were considered by contemporary political economists and other commentators to be 'penal' impositions upon the subject.

1 Eighteenth Century Taxation - Penal Imposition or Payment under (Social) Contract?

Social contract theory constituted the foundation of mainstream social policy, including tax policy, during the late seventeenth and the entire eighteenth centuries. The belief that individuals had gathered together, in entrusting the state to act for their collective welfare, underpinned the prevailing benefit theory of taxation. According to the benefit theory of taxation, individuals were obliged to contribute to the maintenance of the state in proportion to the benefits that they derived from the state:

The expense of government is like the expense of management to the joint tenants of a great estate who are all obliged to contribute in proportion to their respective interests in the estate.

39 Adam Smith, *An Inquiry into the Nature and causes of the Wealth of Nations*, R H Campbell, A S Skinner, W Todd (eds), (1976) 825. See also: Thomas Hobbes, *Leviathan* (1914) 184 (Part II, ch 30): 'For the impositions that are laid on the people by the sovereign power, are nothing
This benefit theory played a significant role in the characterisation of tax legislation in the eighteenth century public policy literature. The conceptualisation of taxes in terms of a purchase of state provided services by the subject, such as the protection of property, the survival of the realm and the maintenance of social order, meant that taxes were not necessarily viewed in the penal light that modern commentators suggest. This awareness of the beneficial aspects of taxation is indicated by the fact that, although it was accepted that taxes constituted the confiscation of private property by the state, very little ink was used in the theoretical literature upon attacking taxes upon the basis of their confiscatory nature:

Every tax, however, is to the person who pays it a badge, not of slavery, but of liberty. It denotes that he is subject to government, indeed, but that, as he has some property, that he cannot himself be the property of a master.

This is not to say that all taxes were automatically accepted by the general population, as the evidence of fierce debates upon the respective merits of particular taxes is overwhelming and there is ample evidence of tax evasion and tax avoidance. However, it is significant that in the contemporary literature there is little or no reference to the 'penal' nature of taxation. The point is that

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40 A point to which I will return later in this chapter, see the text below, under the heading 'The Legitimation of the Pro Revenue Rule of Construction', commencing at p 66.
41 Smith above n 39, 857.
42 For discussion of tax evasion in the eighteenth century see: C Winslow, 'Sussex Smugglers' in Douglas Hay, P Linbaugh and E P Thompson (eds), Albion's Fatal Tree - Crime and Society in Eighteenth Century England (1975). For further discussion of this point see the text below under the heading 'The Weakness of the Taxation System'.
43 W Kennedy, English Taxation 1640-1799 (1913) chs 5, 9; Brewer notes that, given the high level of taxation imposed in England, the absence of any concerted opposition to taxes in eighteenth century England is extraordinary; see: John Brewer, The Sinews of Power (1989) 22-
taxation per se was not necessarily considered to be 'penal', although particular taxes were considered to be more or less 'fair'.

C The Contemporary Appraisal of the Window Tax

1 The Window Tax and Benefit Theory

Leaving to one side this influence of benefit theory upon the characterisation of tax legislation generally, for a number of reasons the window tax itself was considered more favourably than a number of other taxes. Turning firstly to the appraisal of the window tax from the perspective of the benefit theory of taxation, although benefit theory was often cited by the contemporary commentators, there was considerable debate as to how it was to be understood in practice.44 Even within Hobbes’ work it is possible to discern an ambivalence as to the nature of the benefit that a subject derived from the state. At one point he indicated that the fundamental benefit derived from the existence of the state was ‘the enjoyment of life’, which he suggested was equally dear to rich and poor alike.45 However Hobbes continued by noting that wealthier citizens benefited from the provision of state protection of their private property. Whereas the first definition of ‘benefit’ would suggest that a flat tax was appropriate, the second definition of ‘benefit’ was consistent with the imposition of taxation according to the ability of the taxpayer to harness his or her wealth in paying the tax. Hobbes resolved the apparent conflict by accepting that the fundamental benefit should effectively be provided free of


44 For an excellent review of the eighteenth century tax policy literature, see: W Kennedy, above n 43; Cooper, above n 39; HM Groves and D Curran (eds), Tax Philosophers: Two Hundred Years of Thought in Great Britain and the United States (1974).

45 Hobbes, above n 39, 184 (Pt II, ch 30).
charge,\textsuperscript{46} while the wealthier members of any community ought pay for the protection of their wealth. However, the recognition that wealth was an appropriate basis for measuring a subject's benefit raised the question of how wealth was to be measured. Hobbes was not alone in suggesting that the 'benefit' derived by an individual equated with their consumption.\textsuperscript{47} Others maintained that the taxation of property was a superior basis of taxation.\textsuperscript{48} To others, the fact that wealthy traders with high business profits were in a position to escape both the property taxes (by holding little landed property) and the consumption taxes (by consuming relatively little) suggested that various alternative taxes upon revenue ought be adopted.\textsuperscript{49} This debate about the proper application of the benefit principle highlights the polymorphous character of the benefit concept - some equated benefit with consumption, others equated benefit with propertied wealth and others equated benefit with income.

Notwithstanding this debate concerning the nature of the benefit concept, the window tax was viewed favourably from the standpoint of benefit theory. It seems that the assumed correlation between the number of windows in a taxpayer's house and the 'benefit' derived by the taxpayer from the protection afforded by the state, the graduated nature of the window tax,\textsuperscript{50} and the exemption of the poor from the tax meant that it could at least superficially be characterised as one in accordance with the benefit principle.\textsuperscript{51} This is not to say that the window tax was universally considered to be the perfect tax. Some

\textsuperscript{46} Another commentator argued that the lower classes ought be excluded from any liability to taxation because it was already their 'lot' to fight wars and provide their labour; John Cary, noted in Kennedy above note 43, 88.

\textsuperscript{47} Hobbes, above n 39, 184; for discussion of this aspect of Hobbes' work see: Cooper, above n 39, 431-5.

\textsuperscript{48} For discussion of some proponents of a property tax see: E L Hargreaves, \textit{The National Debt} (1930) 31-6, 82.

\textsuperscript{49} Smith, above n 39, vol ii, 825.

\textsuperscript{50} Favourable comment upon this aspect of the window tax may be seen in \textit{The London Magazine} (1747), 123.

\textsuperscript{51} Indeed, in 1778 Lord North justified the window tax on this ground: W Cobbett (ed), \textit{The Parliamentary History of England from the earliest period to the year 1803} (1814), vol 19, 872.
commentators, for example, pointed to instances where the number of windows in a house did not constitute an accurate measure of the benefit derived by the occupant from the state.⁵² The dearth of objections to the window tax in the contemporary tax policy literature therefore that the eighteenth century English community was prepared to overlook the shortcomings of the window tax in light of the generally accepted merits of the tax.

2 The Visibility of the Window Tax

The second characteristic of the window tax which enhanced its appeal was its direct nature. During the eighteenth century there was a widely held preference for direct taxes such as the land tax and the window tax, as opposed to ‘invisible’ indirect taxes such as the excise. Beckett attributes this preference to the belief that direct taxes granted for a specific purpose and for a limited term were the subject of closer Parliamentary scrutiny, by contrast to the traditional sources of crown revenue such as customs duties.⁵³ In a time when the supremacy of Parliament was by no means assured, it was feared that indirect taxes would all too easily enhance the power of the executive arm of government to the detriment of the power of Parliament.⁵⁴

3 The Role of the Local Administration

Yet another favourable feature of the window tax in the eyes of its contemporaries was that it was administered by local government as opposed to the centralised administration of the customs and excise. In more recent times the social significance of the local government in the United Kingdom over the

⁵² See, for example, Smith, above n 39, vol 2, 846.
⁵³ JV Beckett, 'Land Tax or Excise: The Levying of Taxation in Seventeenth and Eighteenth Century England' (1985) 100 English Historical Review 285. Indeed, the development of the Treasury during the latter stages of the seventeenth century is attributable at least in part to the concern of Parliament to entrench stricter controls upon the executive arm; see: Henry Roseveare, The Treasury 1660-1870 (1973) 53-4.
eighteenth and early nineteenth century has been subjected to intensive reexamination. This local administration has been portrayed as a significant component of the ‘social glue’ which contributed to the relative stability within English society over the eighteenth century. The local administration of laws created by the central government reinforced the status of the local gentry within their local communities, afforded them the opportunity for social advancement, and served to integrate the central government with the local communities in a way which administration by the centralised bureaucracy could rarely hope to achieve. In this context the use of the local administration to oversee the imposition of the window tax accorded with one significant discourse within the community and thereby attracted considerable support.

It has also been argued that the discretion wielded by the local administration of parliamentary taxes meant that any perceived inequity in the operation of such laws was considerably tempered. Thus Beckett notes that, in Cumberland, local custom as to the assessment of taxes prevailed, regardless of the means of assessment prescribed in the relevant statute. Further, Braddick has emphasised that this aspect of the local administration of parliamentary taxation was an important safety valve which served to diffuse what might otherwise have been considerable resentment to such taxes. The local administration of the window tax therefore arguably served to diffuse tensions that might
otherwise have arisen with the imposition of such a tax, thereby making the tax more acceptable to some parts of the community.

4 The Non Intrusive Means of Ascertaining Tax Liability

Shortly before the introduction of the window tax, the hearth tax had been repealed at a time when the government was in dire need of revenue. That the hearth tax was repealed at such a time is largely attributable to the sensitivity of substantial portions of the English community to intrusions into their dwellings by tax 'officers' ascertaining the liability to the hearth tax.\footnote{Smith, above n 39, vol 2, 846 (Bk 5, ch ii). For discussion of the administration of the hearth tax see: Braddick, \textit{Parliamentary Taxation in Seventeenth Century England}, above n 57.} By contrast, the number of windows could generally be assessed without any such intrusion into the home,\footnote{Although it was necessary to enter dwellings when there was no other access to the back of terrace houses, or where it was necessary to determine the number of internal windows.} such that this potential cause of dissent was effectively eliminated.\footnote{Indeed, Smith commented favourably upon the administrative aspects of the window tax; Smith, above n 39, vol 2, 846 (Bk 5, ch 2).}

5 The Acceptance of the Window Tax

There are therefore a number of reasons for the initial acceptance and subsequent retention of the window tax. It is doubtful that the window tax was ever considered a perfect tax by eighteenth century standards. However, it is clear that the tax catered to many of the pre-eminent demands of eighteenth century tax policy such that the tax received considerable communal support. Indeed, what is notable about the window tax is that it was the object of relatively insignificant adverse comment over the course of the eighteenth century.\footnote{Whereas other taxes such as the more fiscally significant customs and excise attracted more critical scrutiny. This may be attributable to the greater scale and hence, social significance, of the indirect taxes. However, the favourable comments of Adam Smith upon the inhabited house tax are indicative of the more favourable view of the direct taxes, including the window tax.}
The preceding discussion of the social context of the window tax therefore only serves to heighten the mystery of the apparent contradiction between the generally accepted account of strict interpretation of tax legislation and the historical evidence. The perseverance of the legislature with the generally worded window tax legislation, which was generally considered to be 'beneficial', seems to contradict the account which suggests that the courts construed increasingly detailed tax legislation which was considered to be 'penal.'

This conflict between the generally accepted account of tax interpretation and the historical evidence raises a question regarding the eighteenth century perception of the role of the courts in tax administration. It was noted in the introduction to this chapter that the generally accepted account of the received role of the courts in tax administration after 1688 is that they were considered by contemporaries to be defenders of individual rights against illegal interference by the state. The creation of a jurisdiction in the courts to hear tax matters, shortly after 1688, would be consistent with this historical account. Further, the perceived function of the courts as protectors of the rights of individuals suggests that the tax administration had the capacity to impose tax to the very limits of 'the law'. It is therefore necessary to test these claims against the historical evidence.

1 Local Administration of Central Taxation - An Overview

Atiyah has observed that it is difficult for modern observers to recreate in the mind's eye the nature of social conditions and government in the seventeenth and eighteenth centuries. It is difficult, for example, for a modern observer to understand the extent to which the central government depended upon the local

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level of government for the implementation of all manner of legislation, including the collection of taxes. The power of the central government in modern times may mislead modern observers into assuming that the seventeenth and eighteenth centuries were marked by a gradual assertion of central power over the local arm of government. However, there is a wealth of evidence which suggests that the emergence of the central power of government was by no means an uninterrupted progression to its modern dominance. Indeed, there is a substantial body of literature which suggests that the power of local government had actually increased dramatically in the course of the seventeenth century. The fiscal demands of financing an expensive Civil War had precipitated a new phase in the development of the taxing state, as parliamentary taxes were administered by the gentry at the local level at a time when the yield of direct taxes was the predominant source of central revenue. Although the relative fiscal importance of the direct taxes ebbed in the latter stages of the seventeenth century as successive governments experimented with various centrally administered indirect taxes, the administration of the direct taxes of the eighteenth century continued this tradition of dependence by the central government upon local administration in the hands of the local gentry.

The eighteenth century is therefore marked by a considerable reliance by the central government upon the local level of government. This raises the question of the extent to which the central government was in a position to control local government in collecting the parliamentary taxes. The need to bring the decentralised local administration of county and parish government under centralised control had been recognised in the Tudor and early Stuart periods, when the Privy Council, the Star Chamber and the Provincial Councils had been

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63 See the discussion above, under the heading 'The Role of the Local Administration'.
64 Braddick notes that in the period 1649-1659 the locally administered direct taxes raised 55.22% of national revenue: Braddick, *The nerves of state*, above n 57, 10.
granted jurisdiction to exercise control over decisions made at the local government level. By the Restoration these sites of centralised control over the local administration had been abolished and there was no general statutory right of appeal to the central courts with respect to decisions taken at the local level. Nevertheless, the common law courts retained some control over errant local administrators and justices by virtue of the prerogative writs, presentment and indictment, and also by suit brought against the justices by a private citizen seeking compensation for malfeasance or nonfeasance. But leaving aside the procedural and practical obstacles to maintaining an effective tax administration by recourse to these causes of action, the supervisory powers exercised by the central courts were also inapplicable in the case of discretionary powers exercised by the local justices in tax matters.

These practical obstacles minimised the number of tax matters brought to the higher courts on the prerogative writs.

This is not to suggest that local government officials were a law unto themselves, ignoring legislation passed by the central government without fear of legal or moral retribution. In more recent times there has been a substantial amount of work which re-examines the history of central/local relations. It is generally recognised that the central government wielded only a tenuous influence over local government. However, the modern literature suggests that

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67 See, for example, Anthony Fletcher, *Reform in the Provinces: The Government of Stuart England* (1986); Norma Landau, above n 65.

68 Holdsworth, above n 66; vol 6, 56-66; vol 10, 126-55.

69 Ibid; vol 5, 420; vol 10, 133.

70 The courts had for some considerable time recognised the principle that they could not review the exercise of a discretion, see: Holdsworth, above n 66; vol 10, 252-4.

71 Whilst it might be accepted that not all of the cases on the prerogative writs were reported, the proportion of cases taken on the prerogative writs was relatively small. Arthurs has confirmed this, at least for the year 1830: see: Harry Arthurs, 'Without the Law’ *Administrative Justice and Legal Pluralism in Nineteenth-Century England* (1985).
the history of seventeenth and eighteenth century tax administration is not one of local dissent in the face of central legislation, but rather one of a symbiotic relationship which developed between the central and local levels of government. Such studies therefore present an account of the administration of parliamentary taxation which rectifies the perceived shortcomings of earlier histories, which were marred by an excessive dependence upon the records of the central government. Such records, it is suggested, give a prejudiced view of local government by focusing upon the instances of maladministration and other administrative shortcomings at the local level. In part, the incentive for local administrators to cooperate with the central government is explained by the prestige and power flowing to local office holders. Furthermore, the preparedness of the local gentry to assume the administration of central laws might also be attributable to their recognition of the benefits that the state brought to the local community. Amongst other benefits, central government could pass laws for the protection of property, laws regulating disputes between parishes and laws giving the local gentry greater powers for the fulfilment of their public duties. The local gentry could therefore not help but conceive of ‘the central state’ as more or less ‘their’ state and ‘there’ for them rather than some alien power imposing its will upon local communities.

Whilst conceding the existence of this local cooperation, this chapter examines one aspect of the response of the central government to the perceived shortcomings of the local administrators in their administration of the window tax.

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72 See, for example, MJ Braddick, Parliamentary Taxation in Seventeenth Century England, above n 57, 17-19; cf B E V Sabine, above n 8, 108.
73 Kent, above n 57; Brooks, above n 57.
74 Kent, above n 57.
75 Such a study is therefore not intended to rebut the recent work which has recovered the various local histories of early tax administration, but rather to add another dimension to the narrative.
As we have already seen, in the eighteenth century the tradition of local administration of direct taxes was considered to be an important bulwark of parliamentary control over taxation at a time when that control was by no means assured, and when it was feared that the indirect taxes of customs and excise could all too readily revert to executive control. In 1696 it is therefore understandable that the assessment of the window tax was placed under the control of the commissioners of the land tax for one year, and that the local justices of the peace were to assume responsibility for the local administration of the tax for the remaining six years that the tax was to apply.

The commissioners were to divide according to geographical subdivisions and appoint assessors resident within those geographical subdivisions. The task of the assessors was to inspect the inhabited houses within their geographical division and determine the names of the inhabitants, the number of windows and the amount of tax to be paid in respect of each taxable building. The assessors were then to submit their certificates of assessment to the commissioners within a specified time along with the names of two persons to be responsible for collecting the tax and forwarding it to the Receiver-General. In 1719 the parish or other place nominating the collectors was made responsible for the due performance of the collectors' tasks.

The commissioners were invested with substantial inquisitorial powers of review, being required to scrutinise assessor's certificates and examine an assessor with a view to establishing whether the assessor had failed to correctly assess the residents of the respective parish or district. In the event of such a

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76 (1696) 7 & 8 Will & M, c 18 (Eng), s 6.
77 (1696) 7 & 8 Will & M, c 18 (Eng); see also: (1697) 8 & 9 Will, c 20 (Eng), s 15. The supervision of the commissioners by the justices of the peace was, it has been noted, considered necessary in the light of past maladministration by the commissioners in respect of the land tax; see: Ward, The Administration of the Window and Assessed Taxes 1696-1798, above note 1, 3.
78 (1696) 7 & 8 Will & M, c 18 (Eng), s 6.
failure, the commissioners were empowered to examine the inhabitant of the relevant dwellings in order to ascertain the tax payable.\textsuperscript{80} Further, the commissioners were similarly authorised to conduct appeal hearings in an inquisitorial manner, there being no right of appeal from the decision of the commissioners.\textsuperscript{81} The creation of final powers of determination in the commissioners reflects the importance of the local administration in implementing initiatives of the central government. The absence of rights of appeal beyond the decision of the justices, even to the Quarter Sessions,\textsuperscript{82} might be explained by the perceived need to expedite the collection of revenue\textsuperscript{83} and was also consistent with the tradition of rights of review at the ‘administrative’ level of government.\textsuperscript{84}

3 Why was a Right of Appeal to the Common Law Courts Created?

As Ward has noted, the interests of the central government in the local administration of the window tax were to some extent protected by a body of Surveyors appointed by the central tax office.\textsuperscript{85} Notwithstanding this measure,

\textsuperscript{79} (1719) 6 Geo I, c 21 (Eng), s 61.
\textsuperscript{80} (1696) 7 & 8 Will & M, c 18 (Eng), s 9.
\textsuperscript{81} See: (1696) 7 & 8 Will & M, c 18 (Eng), s 13. Although judicial review under the prerogative writs remained - in the case of the land tax, see: Concerning the Commissioners of the Land-Tax for the City and Liberties of Westminster (1746) Parker 74; 145 ER 717.
\textsuperscript{82} This is significant as Holdsworth might be understood to imply that the rights of appeal to the Quarter Sessions constituted an important check upon the discretion of the local justice of the peace, and therefore was instrumental to the rule of law in eighteenth century England; Holdsworth, above n 66, vol 1, 241ff.
\textsuperscript{83} There was also no appeal from the commissioners of excise, arguably for the reason of expediting the revenue collection; see text accompanying nn 106-107 below.
\textsuperscript{84} See: Dowell, above n 8, vol 1, 193-200; an early example of this right of administrative review is found in Taxation Act 1558 (Eng) 1 Eliz, c 21, s 17 nv; while late seventeenth century examples may be seen in An Act to prevent Frauds and Concealments of his Majesty’s Customs and Subsidies 1660 (Eng) 12 Char II, c 23, s 31; An Act for additional Duty of Excise upon Beer, Ale, and other Liquors 1688 (Eng) 1 Will & M, c 24, s 13. Note, however, that the adoption of a right of administrative review was by no means universal; see, for example, (1662) 3 & 4 Char II, c 10 (An Act for Establishing an additional Revenue upon his Majesty ...) (Eng) (establishing the hearth tax).
\textsuperscript{85} Ward, The administration of the window and assessed taxes, 1696-1798, above n 1, 2. I am indebted to the earlier research conducted by Ward for revealing the sources upon which this part of the thesis is founded.
over its first fifty years the yield of the window tax declined markedly.  

Ward attributes this decline to the preparedness of the local administrators to 'ameliorate' the effects of the tax by making favourable assessments, to taxpayers engaging in various forms of tax avoidance, to the incompetence of significant elements of the administration and also to the limited resources of the centralised tax bureaucracy overseeing the operation of the tax. 

During the 1740's these shortcomings of the window tax administration became all too apparent to the Treasury. Contemporary Treasury correspondence indicates that in at least some parts of England the Commissioners were slow to initiate the assessment process, in other cases they asserted their independence from central control by ignoring instructions from the Surveyors, in other cases they acted contrary to the provisions of the legislation and in some cases they discharged friend's assessments without requiring the taxpayer to declare on oath that they fell within an exempt category. Indeed, the degree of latitude exercised by, if not necessarily allowed to, the local Commissioners is suggested by the practice in Cumberland of raising the window tax by a customary rate called a purvey. For the first fifty years of its life, the window tax legislation was therefore open to the vagaries of interpretation at the hands of the local administrators of the tax.

There was also mounting evidence of the inability of the Surveyors to exercise effective control over the tax machinery. Revelations of Surveyors too busy,
disorganised or disinterested to act created a picture of an ineffectual tax administration.⁹⁴ To be fair, the task of supervising the imposition of a tax upon the local community was not always easy or pleasant. There are reports of overburdened magistrates in the Cumberland district,⁹⁵ while in Newark the assessment process provoked the mob which 'in a tumultuous and disorderly manner and with stones dirt and other things forc't the ... officer from his duty.⁹⁶ Reports from the Taxes Commissioners to Treasury explaining the decline in window tax revenue also emphasised the difficulties experienced by the Surveyors in imposing the window tax in the face of hostility to the tax expressed by the Justices of the Peace:

There is a great decrease everywhere in these duties and that not so much from the above negligence [of the local surveyors] as from the partial and arbitrary proceedings of the Justices in those parts, who will not admit of any surcharges where a regular survey has been made in order to advance the duties, but on the contrary strike them off without examination, as they did lately in Ludlow, Salop, as also in Brecon town, though it appeared that many of the houses had from 30 to 70 lights, and that no appeal was made, they alleging it would be a bad example for one to pay 30 shillings, whilst others in the same circumstances paid but 20 shillings: John Sesse, one of the surveyors of Devon, is incapable of his duty, but the officer lays the blame upon the Justices of the Peace, who suffer the people to come and appeal at any time, and they are taken off without the knowledge of the officer who should be present to defend his charge; for which the clerks to the said Justices receive a fee.⁹⁷

[The Justices of the Peace] are commissioners for these duties, and from whom there is no appeal, excuse when they think fit ...without

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and inefficiency arising from the system of patronage, based upon the medieval conception of a public office being a species of property, see: Holdsworth, above n 66, vol 10, 509ff.
⁹⁴ Shaw, above n 18, vol v, 277-8.
⁹⁵ Shaw, above n 18, vol xii, 337.
⁹⁶ Shaw, above n 18, vol xiii, 337.
⁹⁷ Shaw, above n 18, vol 5, 278; although the understandable willingness of the Taxes Commissioners and the Surveyors to pass the blame onto others, must be borne in mind.
administering oath to appellant or officer, and in some places are persuaded with difficulty to act at all.98

In the 1740's the Treasury therefore portrayed a tale of tax evasion, administrative negligence and subversion at the hands of the local administration which depicted a tax administration in need of major reform. This was brought to the attention of the House of Commons in 1747, when a report detailing the difficulties encountered by the Commissioners of Taxes in administering the window tax legislation was presented to the House.99 Although the report did not mention the maladministration on the part of the Surveyors, the commissioners were characterised as generally exercising their discretion in favour of the taxpayer at some considerable cost to the central revenue:

From our having been frequently acquainted by several of the commissioners of the land tax, and many of our officers, upon their attending the commissioners, that they did not think themselves authorized by the powers given by the Act, as it now stands, to order the assessments to be made according to the instructions given by us to the surveyors, as not thinking the Act sufficiently clear and explicit to justify them in the execution of it, in consequence of such interpretation, which together with the surveyors not being permitted in some places to do their duty, and the methods which have been universally practised in stopping up windows or lights, to evade the payment of the duties granted by the act, have, in our humble opinion, made it necessary to have the said Act explained.100

A central aspect of the report made by the Commissioners of Taxes to the House of Commons was the contention that there was no effective control over the arbitrary decisionmaking of the justices of the peace. The report made it clear that there was a serious loss to the revenue arising from the failure of the

98 Shaw, above n 18, vol iii, 157, 312.
99 United Kingdom, Report to the House of Commons presented by the Commissioners of Taxes, above n 89.
100 Ibid.
justices to adopt the interpretation of the law disseminated by the Commissioners of Taxes through the network of surveyors. Whether or not these reports presented an accurate picture of the administration of the window tax at the hands of the local government, the response to this portrayal of a defective window tax administration was swift. Firstly, incompetent surveyors were replaced and surveyors were thereafter generally appointed by the Treasury. Secondly, in 1748 the existing legislation was replaced by a revised Act which included a right of appeal by way of case stated to the Justices of the Courts of Kings Bench, Exchequer or Common Pleas.

With respect to the second response, according to the generally accepted historical account, the role of the courts was to protect the individual from extralegal exercises of state power. However, the picture of the window tax administration sketched in the preceding paragraphs suggests that the administration of the tax was far from the model of bureaucratic efficiency seemingly assumed in historical accounts of tax interpretation. If the tax administration was as inefficient as government reports of 1747 suggest, it seems odd that Parliament would seek to protect the rights of the subject against the state by creating a right of appeal to the courts in 1748.

Rather than being created for the purpose of protecting the rights of individual taxpayers, the circumstantial material suggests an alternative account of the role of the courts in the administration of the eighteenth century window tax. This alternative account is that Parliament created the right of appeal in order to protect the interests of the central government. Faced with the dire state of the window tax administration depicted in the 1747 Report of the Commissioners of Taxes, and given the history of supervision of local government by the central government.

101 Sabine, above n 92, 22.
102 (1748) 21 Geo II, c 10, s 10; the appeal was to one of the Justices of the Kings Bench, Common Pleas or the Exchequer by way of a case stated after the rights of administrative review.
courts, it is understandable that the central government once again turned to the central power of the courts as a means of constraining errant local administrators. Relatively few reports of decisions made under this mechanism survive, and there has been no detailed study of this extension of the jurisdiction of the central courts. The impact upon the decisionmaking by justices is therefore difficult to ascertain. However, even one hundred years later, the perceived importance of the courts in supervising the local tax administration was recognised by one Tax Surveyor. A consideration of the rights of review under other contemporary tax legislation also suggests that this extension of the supervisory powers of the central courts was founded upon the pragmatic imperative of protecting the central revenue rather than upon the imperative of protecting individuals from abuses of state power. From the perspective of the discourse of individual rights, it is a striking anomaly that the courts were granted jurisdiction with respect to window tax matters but not with respect to the far more important sources of government revenue such as customs and excise. These indirect taxes were already administered by a highly centralised tax bureaucracy which was considered to be the efficient jewel in the bureaucratic apparatus. From the pragmatic perspective of a concern for the central revenue, it is therefore understandable that it was considered unnecessary to grant a jurisdiction to the courts with respect to appeals against the imposition of customs duty. Despite contemporary condemnations of the absence of rights of review in relation to these indirect taxes, proposals to

had been exhausted. After 1823 the cases stated to the Justices in this way were annually to be laid before Parliament annually, see: (1823) 4 Geo IV c 11, s 7.

103 The first examples of control exercised by the courts being the power of the Privy Council, the Star Chamber, and the Provincial Councils; see above n 66.

104 United Kingdom, House of Commons, First Report of the Select Committee on the Income and Property Taxes, (1852) 185-6 (Evidence presented by Mr Hyde, Surveyor of Taxes).

105 Brewer, above n 43, passim.

106 Holdsworth notes that the powers of the excise commissioners, from which there was no appeal, were the subject of adverse comment by Blackstone and Johnson, the latter defining an excise as ‘a hateful tax levied upon commodities, and adjudged not by the common judges of property but wretches hired by those to whom Excise is paid.’; see: Holdsworth, above n 66, vol 10, 454 n 8, 516.
limit the powers of the excise commissioners were rejected by the House of Commons in 1786 and 1790 on the basis that the efficient collection of the revenue called for stringent measures.\footnote{United Kingdom, House of Lords, \textit{Hansard}, 26 June 1786 (Lord Loughborough), 177-8; United Kingdom, House of Commons, \textit{Hansard}, 30 April 1790 (Attorney General), 749-50; for a discussion of this see: Holdsworth, above n 66, vol 10, 516.} That the appeal mechanism was founded upon pragmatic considerations rather than reflecting an endorsement of the protection of the rights of the individual may also be discerned in a 1798 amendment to the window tax legislation, which imposed penalties upon any taxpayer who appealed without success.\footnote{(1798) 38 Geo III c 40.}

From the foregoing discussion it may be seen that, even before considering the judicial interpretation of the window tax, some major modifications must be made to the generally accepted account of eighteenth century tax interpretation. Far from standing between the subject and an efficient tax administration willing to impose taxes beyond the limits of the law, the courts were not even granted a statutory jurisdiction to hear window tax appeals until sixty years after the revolution which had purportedly entrenched the rule of law. In this respect at least, the generally accepted account of the role of the courts with respect to eighteenth century tax legislation must be modified. This modification of tax history to take account of the pragmatic considerations underlying the creation of a jurisdiction in the courts to hear tax appeals raises a further question regarding the generally accepted account of tax interpretation. If the courts were adopting the pro taxpayer construction of tax legislation depicted in twentieth century accounts, granting a right of appeal to the courts in window tax matters might not have benefited the central revenue at all, or might have been of only marginal benefit. If this was the case, why would the legislature invest the courts with a jurisdiction to hear window tax appeals? At this point it is therefore necessary to turn to the third aspect of the generally accepted account

\footnote{United Kingdom, House of Lords, \textit{Hansard}, 26 June 1786 (Lord Loughborough), 177-8; United Kingdom, House of Commons, \textit{Hansard}, 30 April 1790 (Attorney General), 749-50; for a discussion of this see: Holdsworth, above n 66, vol 10, 516.}
of tax interpretation, and examine whether the courts in fact adopted a strict construction of tax legislation.

E The Judicial Interpretation of the Window Tax

1 The Interpretation of ‘Inhabited Dwelling House’

From the brief overview of the window tax legislation set out above, it may be seen that the operation of the tax depended to a considerable extent upon the meanings of the terms ‘inhabited dwelling house’ and ‘window’. The absence of any statutory definition of these terms was also noted. Turning first to the interpretation of ‘inhabited dwelling house’, several questions regarding the meaning of this key element of the window tax base arose over the course of the eighteenth century. In particular, it was unclear whether several otherwise distinct buildings which had some form of internal communication should be treated as one ‘house’. This question was important given the graduated nature of the window tax - generally, the larger ‘houses’ attracted a larger tax liability, as more windows would be assessed to the tax. Secondly, it was not clear whether a ‘house’ which had several uses, and was only partially used as a dwelling, should nevertheless be treated in its entirety as an ‘inhabited dwelling house’. This question was important given the implicit suggestion that the tax only applied to buildings used for habitation, and the consequent problem of determining whether a building which was only partly used for habitation ought be subject to the tax. In 1784 the legislation was amended to specifically exempt buildings used for a range of commercial purposes, but this exemption did not answer the problem of how a building was to be characterised where it was used for several purposes.

The legislation did not specifically impose tax upon buildings that were only partly used for habitation or upon buildings which had some connection with a
dwelling house. Nor, might it be added, did the legislature specifically exempt such buildings. There was therefore considerable doubt regarding the application of the window tax to buildings adjoining a dwelling, or even buildings on the same block of land. After 1784 several questions regarding the scope of the specific exemption of commercial buildings remained. Had the courts been adopting the strict construction rule in this period, it would have been reasonable to expect that any ambiguity in the window tax base would be resolved in favour of the taxpayer. It is therefore necessary to consider the surviving case records to determine whether this was, in fact, the approach adopted by the courts.

(a) 'Dwelling House'

In the case of Strickland and Griffin\(^\text{110}\) the taxpayers were assessed to the window tax with respect to a sugar refinery which was a distinct building used solely for the purpose of sugar refining. Although inhabitable, it was not inhabited but rather was specifically adapted to its industrial use and was insured at a rate appropriate to an industrial building. However, the refinery building was connected to another building by a party wall. Refinery employees who lived in the adjoining building gained access to the refinery by a doorway through the party wall which was closed and locked each night. The refinery was assessed for forty five windows on the basis that it was a ‘dwelling’. The taxpayer appealed and the Commissioners upheld the appeal on the basis that:

> The enumeration and detail of offices in the explanatory act of the 21st Geo II doth demonstrate, that dwellings, and the appurtenances of dwellings, are the objects of the rate; and further, that they humbly

\(^{109}\) (1784) 24 Geo III, c 38, s 34.

\(^{110}\) Reported in J Smee (ed), A Complete Collection of Abstracts of Parliament and Cases with Opinions of the Judges Upon the Following Taxes: viz Upon Houses, windows, servants, horses, carriages and dogs; the duties upon Hairpowder Certificates; and also the Twenty per cent upon the Assessed Taxes (1797) vol 2, 405.
conceive that the silence which is observed in all the window acts with respect to manufactories, is not the result of omission, but of the justice and the tenderness of the legislature to manufacturers, who paying the window-tax for their dwelling-houses, thereby contribute to that aid to his Majesty in full proportion to the rest of the public.

The case being stated for the opinion of the judges in accordance with the Act, the judges\(^\text{111}\) held that the Commissioners were wrong and that the refinery was properly assessed. Clearly there were at least two plausible arguments regarding the operation of the window tax legislation in this case. The reference to ‘dwelling house’ could have been interpreted broadly to include all structures adjoining an inhabited dwelling. Alternatively, ‘dwelling house’ could have been interpreted more restrictively as including only those parts of buildings actually used for residential occupation. It is clear that the former, broader interpretation was adopted by the Courts notwithstanding the formalist submissions of the Commissioners to the effect that something should not be subject to tax if it was not expressly taxed.

A second example of this pro revenue construction of the ‘inhabited dwelling house’ element of the window tax legislation is found in the case of *Fly*.\(^\text{112}\) In that case the taxpayer occupied a block of land on which he had a dwelling house and, in an entirely separate building, a teahouse. The Surveyor argued that window tax should be imposed upon both buildings. Although it might seem that this was a vexatious case brought by the Surveyor, both buildings were held to have been properly assessed on the basis that there was only one means of access to the two buildings from the street, and that they should therefore be treated as one building.

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\(^{111}\) The report notes that Mansfield J and nine other judges unanimously overturned the Commissioners’ decision.

\(^{112}\) Reported in Smee, above n 110, vol II, 420.
Similarly, in the case of *John Haynes*¹¹³ the taxpayer possessed a watermill which was accessible from a dwelling house by one door. The watermill and the house were for all other purposes distinct buildings, being built with different materials and used for quite different purposes. In expressing their opinion for the determination of the judges, the commissioners adopted an objectivist rhetoric quite in keeping with the rhetoric which twentieth century commentators commonly attribute to the courts. This rhetoric would also have been adopted by the eighteenth century courts if they had truly envisaged their role as appliers of ‘the law’ in tax matters:

Where there exists a positive explanatory statute, specifically describing what articles shall be charged, we cannot think ourselves authorized to form a precedent for extending the law for taxing any article not described therein. It does not appear to us that the letter, or even the intention of the statute, can comprehend buildings purposely erected for the carrying on of manufacture or stowing of commodities for sale, although we readily admit it comprehends cellars, chambers, garrets, and passages, which are really and actually internal parts of dwelling-houses, and yet are applied to the uses aforesaid. A distinction of this kind appears to us designed to be made in the last acts of the 18th and 19th of his present Majesty, for granting duties on inhabited houses, from which distinction may be enforced an intention in the legislature, to excuse extensive trades and manufactories in similar cases. We think that a mill which is a distinct building, with a specific application, which does not come under any of the above recited descriptions, and which communicates with a dwelling house by one door only, merely for the sake of convenience, cannot, with any propriety, be deemed part of that dwelling house. We think also that the legislature could not mean to take advantage of such mere convenience to impose a burden on trade, which could not otherwise have been imposed. Had manufactories been designed subject to the tax, it seems reasonable that they should have been explicitly mentioned.

Once again, the Commissioners were overruled upon appeal to the judges, and once again, the record of this decision merely notes the outcome without providing any account of the reasons for this decision.

¹¹³ Ibid 442.
(b) 'Inhabited'

The decisions in Strickland, Haynes and Flyn indicate a preparedness on the part of the judiciary to adopt a pro revenue construction of 'inhabited dwelling house' for the purposes of the window tax. This recognition of a pro revenue approach to the interpretation of tax legislation is also suggested by the judicial interpretation of the requirement that the window tax only applied to 'inhabited dwelling houses'.

A number of cases suggest that the courts allowed the imposition of the window tax where a building was not inhabited as a place of abode. Thus an office used solely for the purposes of fulfilling the functions of a justice of the peace, and at some distance from the justice's dwelling house, was held to be assessable.114 Similarly, a lawyer's offices at some distance from his home were also held to be validly assessed.115 Further, in Broomhead's Case116 a taxpayer owned a house which he only used 'to drink a glass of wine in it, when he comes there, and has four times since Lady-day last dined there with his family, but never lodges in the said house'. Notwithstanding this occasional occupation, the judges held that the house was 'inhabited'.117 A similar conclusion was reached in Sollett and Glass's Case.118 In that case the appellants had residences at a summer resort and also had lodging houses which were let over the summer months. Over the winter months the lodging houses were closed up, but there was a notice placed at their entrances to the effect that the buildings were available for rent. Both the commissioners and the judges held that the lodging houses were inhabited houses, upon the basis that they presumed that 'the said Richard Sollett and William Glass made as much money of their said lodging-

114 Johnson's Case, reported in Sme, ibid, 416.
115 Shaw's Case, reported in Sme, ibid, 483; see also: Holford's Case, reported in Sme, ibid, 464.
116 Ibid 385.
117 Similar decisions may be found at, North Riding LangBurgh East Division; William Tullie reported in Sme, ibid, 384; Cardiganshire: George Smedley reported in Sme, ibid, 384.
118 (1785) 8 Price 127; 146 ER 1152.
houses, in one summer, as the annual rent of their said houses would amount to, if let by the year.' 119 This decision once again illustrates the preparedness of the courts to accord a broad scope to the provisions imposing the window tax upon 'inhabited dwelling houses'.

Nevertheless, there were exceptional cases where the courts appeared to exercise a discretion in favour of the taxpayer, but from the available records it seems that such cases were relatively rare. Thus, for example, a house available for lease as a fully furnished house which had been occupied for only six months of the year was held to be unoccupied for that period, and an abatement of the window tax allowed. 120 However, from the available records it seems that such a result in favour of the taxpayer was most exceptional, the norm being illustrated by the decision in favour of the central revenue in Wright's Case, 121 the facts of which were indistinguishable from Durno.

2 The Interpretation of 'Window'

Another example of a willingness to adopt a liberal construction favouring the revenue even into the nineteenth century is the broad definition of 'window' adopted by the judges. For example, a hole for the deposit of coal was held to constitute a window, 122 while in another case a cellar grating with iron bars which admitted so little light that a candle was required during daylight hours was held to constitute a window. 123 Further, four perforated zinc plates installed for the purposes of ventilating a pantry were held to constitute windows. 124

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119 The one line decision of the court reads 'We are of the opinion that the determination of the Commissioners is right'. Similar decisions may also be found in Skinner's Case (1787) 8 Price 124; 146 ER 1153; Wright's Case (1808) 8 Price 125; 146 ER 1154.
120 James Durno; Kensington gravel pits; reported in Smee, above n 110, vol 11, 397.
121 (1808) 8 Price 125; 146 ER 1154.
122 Case 1444 - County of Cambridge, Division of Newmarket, United Kingdom, House of Commons, Parliamentary Papers, 1841, vol 20, 379.
123 Case 1546, nv; noted in Dowell, above n 8, vol 3, 176.
124 Case 1894, nv; noted in Dowell, ibid, vol 3, 176.
Other cases indicate a willingness of the judges to fill lacunae in favour of the revenue. For example, in 1784 it was enacted that a house was not to be considered to be inhabited unless it was occupied by the owner or a tenant.\(^{125}\) In *Levett's Case*\(^{126}\) a house was occupied by the owner's brother gratuitously, but the Surveyor argued before the commissioners that to exempt the gratuitous occupier of premises from the tax was contrary to the 'true intent and meaning of the Act'. The commissioners upheld the taxpayer's appeal on the basis of what they considered to be the literal meaning of the words of the legislation.\(^{127}\) However, the judges overturned the decision of the commissioners, there being no record of any reasons given for this decision.\(^{128}\)

In another case\(^{129}\) a house spanned two parishes. If the house was assessed in each parish with respect to the windows in the respective parish, the occupier would have obtained the benefit of the tax free threshold and the lower marginal rates twice over in respect of the same dwelling. The legislation called for assessment and collection of the tax at parish level. If the ambiguity had been resolved in favour of the taxpayer, the occupier would have obtained the tax windfall. However, the judges overturned the decision of the commissioners who had adopted an interpretation in favour of the taxpayer. Although no reasons are given in the judgment, the court apparently accepted the Surveyor's argument that the window tax was not a parochial charge, and that the house should accordingly be assessed as if it were in one parish and the potential for the tax windfall thereby removed.

\(^{125}\) (1784) 24 Geo III, c 38, s 38.
\(^{126}\) Reported in Smee, above n 110, 504.
\(^{127}\) Ibid; this decision was expressed thus: 'We, the commissioners present at the said appeal, are of opinion, that the house in question is, under the express words of the abovementioned clause, exempt from the payment of the said duty.'
\(^{128}\) Ibid, for a similar decision on similar facts see: *Edwards Case*, reported in Smee, above n 110, 505.
\(^{129}\) *In re John Moore; Suffolk, Plomesgate Hundred*; reported in Smee, ibid, vol II, 423.
**F Significant Features of the Window Tax Decisions**

For present purposes there are three striking features of these window tax decisions. Firstly, from the preceding selection of window tax cases decided during the 100 years from 1750 to 1850, it may be seen that the judiciary generally adopted a construction of the legislation which favoured the revenue in the particular case, and that this approach survived until well into the nineteenth century. In itself, this conclusion is enough to warrant a revision of the generally accepted account of eighteenth century tax interpretation by the courts. However, the window tax cases stand for more than the proposition that the courts appear to have found in favour of the revenue authorities. After all, such a result might be explained by the fact that the legislation was well drafted and that, even though the courts were adopting a strict construction of the legislation, they had no option but to find in favour of the revenue authorities.

This leads one to the second striking feature of the window tax cases, which is the methodology of interpretation apparently adopted by the courts. It is clear that, in adopting the pro revenue construction of the window tax legislation, the judges rejected the submissions of the Commissioners which were founded upon a formalist conception of law and the judicial role. Had the courts accepted such a formalist understanding of the law, it is quite possible that they would have adopted the rhetoric of a strict construction, and at least purported to interpret the tax according to its 'literal meaning', or perhaps even more directly referred to the legislative intention. While the judgments in the window tax cases are exceptionally brief, almost invariably amounting to no more than a one sentence statement of the result, it seems that the judges were not applying the strict construction rule by resolving statutory ambiguities in favour of the taxpayer. The inclusion of solicitors' offices in the meaning of inhabited dwelling house, the preparedness to include the windows of buildings which shared the same access with an inhabited dwelling house, the preparedness to include a wide range of apertures within the purview of the term 'window' and the preparedness to resolve legislative lacunae in favour of the revenue
authorities all suggest that the courts were not resolving ambiguous statutory language in favour of the taxpayer. If anything, such ambiguity was being resolved in favour of the revenue authorities.

The third striking feature of the window tax cases is the brevity of the judgments in the superior courts, even by contemporary standards. Modern observers accustomed to reading lengthy statements of judicial reasoning might have expected that this methodological issue would have attracted close judicial scrutiny, or at least that the courts would have prepared statements of reasons for preferring the interpretation of the legislation more favourable to the revenue. This expectation is all the more reasonable given that the subject of taxation had been at the forefront of the constitutional crises of the seventeenth century, and remained the subject of considerable public debate over the course of the eighteenth century. It is therefore significant that in opting for a broad construction of the legislation in favour of the revenue, the courts only rarely offered any detailed reasons for preferring such an approach. Of course, it may be that the case reporters did not consider it necessary to record those reasons. However, Smee's reports of the window tax cases contain quite detailed accounts of the cases stated by the Commissioners.130 It therefore seems fair to assume that if the courts had given reasons for their decisions, the case reporter would have included those reasons in the record of judgment.

This diminution of the significance of the reasons for the decision, and in particular, any recourse to a formalist rhetoric of discovery of the law, suggests that it was the practical consequences of a decision which figured more prominently in the legitimation of the judicial function rather than any purported adherence to a formalist theory of law. If anything, it was the local government Commissioners who were generally in step with what is commonly accepted to be the Lockean philosophy of individual rights. The courts, on the other hand,

130 Smee, above n 110.
appear to have ignored the new philosophy of private property and in resorting to a more pragmatic rule of statutory construction which asserted the priority of the Crown at the expense of the 'rule of law'.

It was because of this preparedness of the judiciary to forsake the 'rule of law' in the context of the window tax that the drafting of the legislation seems to contradict the generally accepted account of legislative drafting in the eighteenth century. Far from the courts precipitating the need for more detailed legislation by their adoption of a literal construction of a 'penal' statute, the opposite was the case. Indeed, it was the judiciary's broad application of the tax to such 'inhabited houses' as dairies which lead to the legislature being petitioned to specifically exempt such commercial buildings.131 Further, in response to the judicial preparedness to adopt a broad interpretation of the window tax evident in the case law considered above, in 1784 the legislature specifically exempted windows which were a part of a dwelling used for the purposes of a manufacturory, trade, vocation or calling.132 Similarly, the legislature had exempted hospitals, charity schools or houses provided for the reception and relief of poor persons.133 By contrast to the broad interpretation of the window tax adopted by the courts, the reports to the central government regarding the local administration of the tax indicated a need for constraints to be imposed upon the local administrators. Of the little detailed statutory elaboration of the window tax base that occurred in the eighteenth century, it is therefore reasonable to suggest that the bulk of the specific rules were directed to the perceived need to provide detailed rules to the local administrators of the tax. The development of specific statutory window tax rules may therefore be explained by the perceived need to control the local administration rather than

131 (1796) 36 Geo III, c 117 (An Act to exempt certain windows) (Eng).
132 (1784) 24 Geo III, c 38, s 34.
133 (1784) 24 Geo III, c 38, s 35.
such rules being attributable to the strict construction of the legislation by the courts.

This account of the pragmatic judicial interpretation of the window tax legislation clearly constitutes a major threat to the generally accepted account of eighteenth century tax interpretation. At this point the key question is whether the pro revenue construction of tax legislation, and the judicial rejection of legal formalism in the window tax cases, was generally adopted in the adjudication of all tax cases in the eighteenth century.

G Was the Interpretation of the Window Tax Consistent with the Approach Adopted with Respect to Taxing Statutes Generally?

A review of available case law supports the conclusion that this pro revenue construction adopted by the courts in the interpretation of window tax legislation was not restricted to the interpretation of the window tax. Thus, in *Camplin v Bullman*¹³⁴ it was recognised that the construction of tax legislation in favour of the revenue was a maxim of general application:

> Before I enter upon the particular consideration of the statute of Tunnage and Poundage, I would premise the known distinction between statutes which grant a revenue to the King, and statutes, or clauses of statutes, which inflict a forfeiture or penalty; the former (especially where the revenue is granted for the excellent purposes mentioned in the preamble) are to be favourably and beneficially construed for the Crown, but the latter are of strict construction, and are not to be extended.¹³⁵

Indeed, the principle that taxing statutes were to be interpreted in favour of the Crown was frequently accepted either expressly or impliedly,¹³⁶ and was never

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¹³⁴ (1761) Parker 198, 206; 145 ER 755, 758.
¹³⁵ Ibid 206; 758.
¹³⁶ *Vere v Sampson* (1662) Hardres 205; 145 ER 454 adopted a broad reading of the revenue statute, although the court did not expressly rely upon the principle that tax legislation was to be construed liberally. Nevertheless, the suggestion that a tax act was a penal statute which ought be construed strictly was raised by counsel for the defendants but rebutted by counsel for the
expressly contradicted, in the case law of the eighteenth century and the early nineteenth century. As late as 1815 the Court of Exchequer maintained in Attorney-General v Newman\(^{137}\) that ‘even if it were a doubtful case on the construction of the statutes, it is a clear rule, that the right of the Crown is not to be taken away by doubtful words or ambiguous expressions.’\(^{138}\) There can be no doubt that this pro revenue construction had assumed an axiomatic status over the course of the eighteenth century, the editors of Blackstone asserting that ‘it is considered a rule of construction of revenue acts, in ambiguous cases, to lean in favour of the revenue. This rule is agreeable to good policy and the public interest; but, beyond that, which may be regarded as established law, no one can ever be said to have an undue advantage in our courts.’\(^{139}\)

Aside from the pro revenue construction of tax legislation throughout the eighteenth century, there is also some indication of a relaxation of the rules of evidence to enable the revenue to prosecute actions for recovery of unpaid taxes. Thus, in \(R v\) Grimwood\(^{140}\) Chief Baron Thomson observed:

\begin{quote}
The admissibility of these books in evidence, has been settled in this Court, from time to time to be proper; and, indeed, they are the only
\end{quote}

informant. See also: Holton v Raworth (1664) Hardres 358; 145 ER 496 (argued on behalf of the Crown and also implicit in the judgment of Turner B); Terry v Huntington (1669) Hardres 480, 484; 145 ER 557, 559; Tanner v Allfriend (1718) Bunbury 36; 145 ER 586; Re Commissioners of the Land-Tax for the City and Liberties of Westminster (1746) Parker 74; 145 ER 717; Camplin v Ballman (1761) Parker 198; 145 ER 755; Attorney-General v The Case Plate Glass Company (1792) 1 Anst 38; 145 ER 793; Attorney General v - (1795) 2 Anst 558; 561, 145 ER 966, 967; Attorney-General v Brewster (1795) 2 Anst 560; 145 ER 966; Attorney-General v Newman (1815) 1 Price 437; 145 ER 1455, 1458; Scott v Allsopp (1816) 2 Price 20, 32; 146 ER 8, 12 (Richards B); Attorney General v Coote (1817) 4 Price 183, 189; 146 ER 433, 435 (Garrow B); In re Wootton (1818) 6 Price 101, 106; 146 ER 754, 755; Attorney General v Delano (1819) 6 Price 383, 393; 146 ER 841, 845 (note that the principle that taxing legislation ought be construed in favour of the revenue was alluded to by counsel, but not judicially, in this decision); Attorney-General v Jefferys (1824) 13 Price 545, 572, 580; 147 ER 1077, 1086 and 1088; Attorney-General v Slee (1824) M'Cle 568; 148 ER 237; R v Tregoning (1828) 2 Y & J 132, 138; 148 ER 862, 865; Attorney-General v Bell (1828) 2 Y & J 431; 148 ER 987.

\(^{137}\) (1815) 1 Price 437, 447; 145 ER 1455, 1458.

\(^{138}\) Ibid 447; 1458.

\(^{139}\) W Blackstone, Commentaries on the Laws of England (1809) vol 1, 323.

\(^{140}\) (1815) 1 Price 369; 145 ER 1432.
evidence adducible in such cases, consistently with the excise business; for if all the officers during the period to which they relate were necessarily to be called to substantiate them by proof, there would, in most instances be an end of recovering duties in arrear.\textsuperscript{141}

There is therefore a considerable body of evidence justifying the conclusion that throughout the eighteenth and early nineteenth centuries the judiciary, with only rare exceptions,\textsuperscript{142} construed taxation legislation with the object of favouring the revenue.\textsuperscript{143} However, there were limits to this pro revenue construction. In particular, where the legislature had imposed penalties for a failure by a taxpayer to comply with the taxation law, the courts generally had no hesitation in identifying such provisions as 'penal', and accordingly adopted the rhetoric of a 'strict' construction in applying those provisions.\textsuperscript{144}

1 The Beginning of the Demise of the Pro Revenue Construction of Tax Legislation

However, by the 1820's the tide was turning against this protective role played by the courts, with the first recorded decision declaring a strict construction of revenue statutes appearing in \textit{Ramsden v Gibbs} in 1823.\textsuperscript{145} In that case Holroyd J\textsuperscript{146} stated that the rule for the construction of revenue statutes was that 'in order

\textsuperscript{141} Ibid 372; 1433.
\textsuperscript{142} \textit{R v Inhabitants of Wimbledon} (1797) 3 Anst 855; 145 ER 1061. The outcome of this case was effectively reconsidered and a result favourable to the Crown relying upon another provision reached shortly afterwards in \textit{R v Inhabitants of St. Georges, Hanover Square} (1797) 3 Anst 920; 145 ER 1082.
\textsuperscript{144} In \textit{Doe Qui Tam v Cooper} (1719) Bunbury 44; 145 ER 589 the court ordered a taxpayer to pay unpaid duty rather than forfeit the dutiable wine, notwithstanding that the relevant legislation directed that the wine ought be forfeited to the Crown, the reasons for this decision are not provided. \textit{Holden Qui Tam v Weeden} (1723) Bunbury 177; 145 ER 638; \textit{Lister Qui Tam v Priestley} (1811) Wight 405; 145 ER 1308; Cf \textit{Attorney-General v Forge} (1801) Forrest 105; 145 ER 1127.
\textsuperscript{145} (1823) 1 B & C 319; 107 ER 119. For the purposes of this thesis I examined every decision reported in the English Reports to determine whether it dealt with a taxation matter, and read every judgment in those cases which dealt with a taxation matter.
\textsuperscript{146} Best J concurring.
to make the subject liable to the payment of a tax, the language of an Act of Parliament ought to be clear and unequivocal, so as to leave no reasonable doubt of the intention of the Legislature to impose a burden upon the subject.  

Given the long history of the rule that revenue statutes were to be construed favourably to the revenue, it might have been expected that such a dramatic turnaround would have been supported by some reasoning for the change. Instead, Holroyd J stated the new approach as if it were long accepted dogma. This was quickly followed in 1825 by Bayley J confidently declaring in the case of *Denn v Diamond* that 'it is a well settled rule of law, that every charge upon the subject must be imposed by clear and unambiguous language.'

Although advocates of the pro revenue construction fought a rearguard action, it ultimately receded from prominence as the formalist rhetoric of literalism and strict construction moved to centre stage. The rule requiring a construction favourable to the revenue was not expressly referred to after 1815. Nevertheless, other judges of the Court of Exchequer continued to adopt a liberal construction of taxing statutes at least late into the 1820's. Thus, in *Attorney-General v Bell* the Attorney-General argued that the excise upon glass should be interpreted in such a way as to fill a casus omissus. All of the judges noted that the intention of the relevant provision was to eliminate the prospect of fraud on the revenue, and expressed a willingness to interpret the provision accordingly. Vaughan B noted that if the statutory provision were a penal provision he would have upheld the interpretation advanced on behalf of the taxpayer. However, he continued, as this was a provision requiring the

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147 *Ramsden*, above n 145, 324; 121.
148 (1825) 4 B&C 243; 107 ER 1049.
149 Ibid 245; 1050.
150 *Attorney General v Newman* (1815) 1 Price 437; 145 ER 1455.
151 *Attorney-General v Jefferys* (1824) 13 Price 545; 147 ER 1077; *Attorney-General v Slee* (1824) M'Cle 568; 148 ER 237; *R v Tregoning* (1828) 2 Y & J 132, 138; 148 ER 862, 865; *Attorney-General v Bell* (1828) 2 Y & J 431; 148 ER 987.
152 (1828) 2 Y & J 431; 148 ER 987.
153 Ibid 442-443, 992 (Alexander CB); 443, 992 (Garrow B) and 444, 992 (Vaughan B).
payment of a duty, the interpretation proffered for the taxpayer 'would in my opinion be contrary to the manifest intention of the Legislature, and open a door to the commission of the very fraud which the act of Parliament intended to guard against.' Further, perhaps in recognition of the doctrine of stare decisis, in the context of the window tax the courts continued to adopt a broad construction of its terms for some decades.

Notwithstanding this rearguard action on the part of judges in favour of the pro revenue construction of tax legislation, the principle of strict construction was repeated with sufficient regularity in the courts to indicate that it was rapidly accepted as the norm for the construction of revenue legislation. Subsequent cases rationalised this 'strict' approach to revenue statutes on the basis that they were properly characterised as 'penal'. The commentators had therefore concluded by the mid-nineteenth century that it was a 'well settled rule of law' that tax acts were penal and therefore to be interpreted strictly.

H The Interpretation of Tax Legislation Compared with the Interpretation of Statutes Generally in the Eighteenth Century

It is clear that the judicial interpretation of tax legislation in the eighteenth century was influenced by a pragmatic concern to protect the interests of the central government. This raises the question of whether all legislation was interpreted with the pragmatic objective of enhancing the power of the central government. During the eighteenth century there were at least two often

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154 Ibid 444, 992; note that, upon a retrial, the jury delivered a special verdict for the taxpayer, although the interpretation of the Court of Exchequer was applied, see: Attorney-General v Bell (1830) 1 C & J 237; 148 ER 1406.
155 As noted at n 102 above, after 1823 cases stated to the central courts were laid before the Parliament. A review of these case decisions suggests that the courts continued to adopt a broad construction of the window tax legislation until it was repealed in 1851. See the discussion of the case law above, particularly under the heading 'Window'.
156 Ramsden v Gibbs (1823) 1 B & C 319; 108 ER 119; Attwood v Small (1827) 7 B&C 389; 108 ER 768; Denn v Diamond (1827) 7 B & C 389; 108 ER 768; Doe v Snaith (1832) 8 Bing 153; 131 ER 352, 359; Re Bruce (1832) 2 C & J 436; 149 ER 185
overlapping discourses with respect to the interpretation of all legislation. Both of these discourses tended towards an emphasis upon the rights of the individual and might quite readily have provided sufficient justification for the eighteenth century courts to adopt a narrow reading of tax legislation.

The first discourse had developed during the seventeenth century, and suggested that legislation ought be categorised as either ‘penal’ or ‘beneficial’, with unique rules of construction applicable to each category. Thus, when writing in the early seventeenth century concerning a statute empowering nominated Commissioners to impose rates for the construction of sewers, Callis argued that ‘this statute ...[shall] be expounded with as much favourable equity as can be, to enlarge the letter of the law in the sense of construction; because it tends so much to the advancement of the commonwealth.’¹⁵⁸ That the application of this categorisation of statutes entailed some arbitrary distinctions because ‘every statute is penal to somebody’ was raised by counsel in Platt v The Sheriffs of London.¹⁵⁹ Notwithstanding these problems of definition it is generally accepted that, over the course of the eighteenth century, a growing recognition of individual rights was reflected in the adoption of a rhetoric which emphasised the necessity of a ‘literal’ or ‘narrow’ interpretation of ‘penal’ legislation. Thus, with respect to criminal offences, it has been argued that this trend towards a narrow construction was the judicial response to the introduction of the death penalty across a broad range of crimes, particularly those against property.¹⁶⁰

¹⁵⁷ See, for example, F Dwarris, A General Treatise on Statutes (1848), vol 2, 646.
¹⁵⁸ Robert Callis, The Reading of that Famous and Learned Gentleman, Robert Callis Esq...upon the Statute of 23 H. 8 cap.5 of Sewers (1685), 95-6; for a discussion of Callis’ work see: Clive Holmes, ‘Statutory Interpretation in the Early Seventeenth Century: The Courts, the Council and the Commissioners of Sewers’ in J Guy and H Beale, Law and Social Change in British History: Papers Presented to the Bristol Legal History Conference 14-17 July 1981 (1984) 107.
¹⁵⁹ (1551) 1 Plow 35, 36; 75 ER 57, 59.
¹⁶⁰ See, for example, Sir Leon Radzinowicz, A History of English Criminal Law (1948) vol 1, 83-91, 97-103; Douglas Hay, ‘Property, Authority and the Criminal Law’ in Douglas Hay, P Linbaugh and EP Thompson (eds), Albion’s Fatal Tree - Crime and Society in Eighteenth Century England (1975) 17 at 32. Hay argues that this strict construction was merely part of a broader process by which the ruling class wielded authority in order to retain control without the
From the late seventeenth century, some statutes affecting property rights were also classified as penal. Thus, a statute awarding costs fell within the ‘penal’ category,\(^{161}\) while statutes imposing a fine,\(^ {162}\) excluding certain women from a dowry,\(^ {163}\) allowing the summary appropriation of property\(^ {164}\) and those imposing fees and taxes under private Acts of Parliament\(^ {165}\) were also included within the ‘penal’ category over the course of the eighteenth century.

This preparedness, on the part of the courts, to include a wide range of statutes within the ‘penal’ category has lead some commentators to suggest that there was a discourse which embraced a narrow, literal construction of all statutes during the course of the eighteenth century.\(^ {166}\) This second discourse was founded upon the acceptance of the separation of powers and judicial deference to the sovereign lawmaking power invested in Parliament and the executive.

Regardless of the relative strengths of these two discourses, the preceding overview of the judicial interpretation of tax legislation during the eighteenth century portrays the judicial resistance to the inclusion of legislation imposing public taxation within the ‘penal’ category. Further, the preceding overview of the relevant case law also suggests that the courts accepted that the rhetoric of individual rights had no direct application to the interpretation of tax legislation.

This exclusion of tax legislation from the strict construction maxim is remarkable for two reasons. Firstly, the pro revenue construction of tax legislation is startling when it is recalled that it had been disputes about the

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\(^{161}\) Cone v Bowles (1691) 1 Salk 205; 91 ER 182.

\(^{162}\) Hooker v Wilks (1740) Barnes 12; 94 ER 783.

\(^{163}\) Kent v Whitby (1738) 3 Bro Parl Cas 487; 1 ER 1451.

\(^{164}\) ‘All Acts which compel a man to part with his property in a summary way must ever be pursued strictly, and the power be fully set forth whereon such an authority is given, derogatory to the common law.’ Anon (1774) Loft 438; 98 ER 735; Rex v Croke 1 Cowp 26, 29; 98 ER 948, 950 (Lord Mansfield).

\(^{165}\) Gildart v Gladstone (1809) 11 East 675, 685; 103 ER 1167, 1171.

\(^{166}\) Corry, above n 30, 296.
power of the Crown to arbitrarily impose taxes which had precipitated the constitutional crises of the seventeenth century. Given the constitutional conflicts of the recent past regarding the power to impose taxes, it might have been expected that the strict construction rule would have been applied to tax legislation much earlier, and perhaps even been amongst the first categories of statutes to fall within the scope of the rule. Instead, it was not until the third decade of the nineteenth century that some members of the judiciary signalled a change to a more overtly formalist rhetoric in the context of tax interpretation. Only after the mid-nineteenth century was the strict construction rule generally considered to apply to legislation imposing public taxation. It is therefore clear that the liberal theory espoused by John Locke was not immediately adopted by the judiciary with respect to taxation statutes in the way that some commentators would appear to suggest.  

The second striking aspect of this judicial intransigence with respect to the pro revenue construction maxim is that it is found in an era in which the courts were clearly prepared to redefine their powers in light of the new constitutional epoch. An essential part of this redefinition of judicial power required a reconsideration of the approach adopted in interpreting statutes. In the eighteenth century all of the rules of statutory construction were therefore open to review. Some, such as the rules for construing criminal statutes, were altered markedly as the judiciary reconsidered its function. Other rules, such as that favouring the revenue in tax statutes, remained unchanged until at least the third decade of the nineteenth century when the first steps towards a narrow construction were taken.

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167 Corry does not expressly consider the interpretation of taxation legislation, but it is implicit in his thesis that taxation statutes also received a strict construction during the eighteenth century; ibid, 295-296.  
I What was the Basis for the Pro Revenue Approach Adopted by the Courts During the Eighteenth Century?

From the preceding overview of the interpretation of tax legislation in the period 1689 to 1830 it may be seen that a judicial rhetoric of formalism in the context of tax legislation did not emerge until the 1820's, and that prior to that time the courts had been adopting anything but a formalist interpretative methodology. The longevity and general application of the pro revenue construction doctrine suggests that it was not an historical anomaly, the product of an idiosyncratic judge or some form of 'mistake' in the sense suggested by Dworkin. Further, it is clear that the persistence of the pro revenue rule of construction was not just an instance of acquiescence in the status quo by eighteenth century taxpayers. There is evidence that the judges expressly declined the invitations of taxpayers and the local administration to adopt a strict construction of revenue statutes instead of a pro revenue construction.

This delayed emergence of legal formalism, in the context of the interpretation of tax legislation, until long after a formalist rhetoric had been adopted in other fields of law leads to the conclusion that the mainstream account of tax interpretation in the eighteenth century is less than convincing. Given that the interpretation of tax legislation was driven by the pragmatic standpoint of the imperative of protecting the revenue, rather than from the formal perspective of applying the determinate meaning of the legislation, it is clear that the function of the courts could not have been legitimised to contemporary observers in terms of the need to protect the rights of the individual against 'penal' laws such as tax legislation.

170 In *Vere v Sampson* (1662) Hardres 205; 145 ER 454 the suggestion that a tax act was a penal statute and ought be construed strictly was raised by counsel for the defendants but rebutted by counsel for the informant; see also: *AG v Cavendish* (1810) 145 ER 1183 at 1186; *Attorney-General v Borrodaile* (1814) 1 Price 148, 157; 145 ER 1359, 1362.
171 See, for example, Corry, above n 30.
This pragmatic adjudication of tax cases in the eighteenth century therefore raises a number of questions regarding the contemporary perception of the role of the courts in eighteenth century tax adjudication. Why was it considered appropriate that tax legislation, one of the most obvious intrusions upon private property by the state, ought be interpreted with a view to enhancing the intrusive powers of the state with respect to the property rights of individuals? How could the courts have established their claim to legitimacy in the eyes of the eighteenth century community when they seemed to stand still against what is represented as the irrepressible force of the liberal ideology of the sanctity of property? Why was it that, in only a handful of relatively insignificant cases, the courts were granted a jurisdiction to hear tax appeals, leaving the administration of the more significant taxes such as customs and excise to the exercise of executive power which was largely beyond judicial supervision? Does this limited jurisdiction of the courts, and the pro revenue construction of the tax legislation over which the courts had jurisdiction, suggest that the eighteenth century British community was less committed to the rule of law than is commonly portrayed in modern discussions of eighteenth century tax interpretation?

1 A Partial Judiciary?

These are fundamental questions, answers to which must be attempted if a more accurate picture of eighteenth century tax adjudication is to be developed. However, before attempting to answer these questions it is necessary to exclude one possible answer. One possible explanation for the pro revenue interpretation adopted by the judiciary is that at least some of the institutions and doctrines of the ‘Dark Ages’ survived long after 1689. It might be suggested that the ‘political’ arm of government, including the monarch, continued to influence or control the judiciary until the nineteenth century. Judges mindful of their future might therefore have adopted a construction of tax legislation
favourable to the central government. It is therefore necessary to take a few moments to discount this explanation of the pro revenue rule of interpretation.

In the seventeenth century the monarch could have used the power of appointing and dismissing judges to the advantage of the revenue, by appointing only those committed to the protection of the Crown revenue and dismissing those who threatened to undermine the revenue.\(^{172}\) However, after the *Act of Settlement* 1701 judges were generally appointed during good behaviour for the life of the monarch, the only means by which they could be removed being upon an address to both houses of Parliament\(^ {173}\) and their subsequent dismissal by the monarch.\(^ {174}\) Moreover, in 1760 George III acceded to the throne, relinquishing his right to dismiss judges appointed by his predecessor. Parliament was quick to pass legislation embodying this further protection of judicial independence into the statute law.\(^ {175}\) Thus, by 1701 the judiciary had achieved considerable formal independence from the Crown, and the process was complete in 1761. The survival of the pro revenue doctrine long after the demise of the monarch's formal control over judicial appointments would therefore seem to discount the suggestion of monarchic control over the judiciary as the source of the pro revenue doctrine.

\(^{172}\) There is no doubt that the monarch had used the power to appoint and dismiss judges to stack the court in favour of the Crown interests, particularly in the reigns of Charles II and James II. For a discussion of this see: Holdsworth, above n 66, vol 6, 503-514. For the king's suggestion that nominations for the bench be screened by the treasury to ensure that judicial appointees would act in the interests of the Crown see: Shaw, above n 18, vol 3, 344, 351. It should be noted that, notwithstanding the power of the monarch, the judges did not always comply with the wishes of the Crown - for examples of this drawn from the early seventeenth century see: Holdsworth, above n 66, vol 5, 351-2.

\(^{173}\) (1701) 12 & 13 William III c 2, s 3.

\(^{174}\) The Act of Settlement also required that judicial salaries be ascertained such that the possibility of judges being placed under political pressure by arbitrary variations to their income was reduced.

\(^{175}\) (1760) I Geo III c 23; note that by (1707) 6 Anne, c 7 (An Act for the Security of her Majesty's Person and Government) (Eng) s 8 judges and other nominated officers of the Crown had retained office for six months after the termination of the Crown.
However, while the monarch had ceded formal control over judicial appointments, informal influence remained. Until the formation of political allegiances along party lines in the early nineteenth century, the House of Commons was only loosely divided between the landed interests and the moneyed interest. In the absence of any concentration of power within Parliament, the Crown retained considerable influence over appointees to high government office. It might therefore be argued that appointees to judicial office would be expected to maintain views conducive to the monarch’s interests. Further, the monarch had ceded formal control over judicial appointments to the government, itself interested in maximising the revenue. According to this hypothetical argument, the prospect of promotion to higher judicial office, known as translation, would secure the ongoing allegiance of the judiciary to protecting the interests of the government.

However, it has already been noted that, even when the king held de jure power over the appointment and dismissal of judges, the judges would not necessarily adopt views in accordance with the king’s interest. It is therefore a most implausible account which suggests that judges were motivated by self interest in maintaining the pro revenue construction rule, particularly when that doctrine was sustained without serious judicial challenge by generations of judges over

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177 Blackstone noted that the decline in the de jure power of the king was not necessarily matched by a decline in the de facto power of the king: Blackstone, above n 139, vol 1, 325-6.

178 In the period 1727 to 1875 almost one half of the appointees to the offices of Lord Chancellor and Chief Justice were by way of the process of translation: Duman, above n 168, 90.

150 years. Such a theory of conspiracy and cynicism does not explain why the pro revenue construction rhetoric was jettisoned in the early nineteenth century. Moreover, there is an element of truth in Thompson’s suggestion that a partial legal administration could not hope to retain any legitimacy over such a long period.\textsuperscript{180} If the pro revenue rule of construction had been adopted in spite of widespread communal dissent, one might have expected that the judicial interpretation of tax legislation would have attracted at least some critical comment. There is no suggestion in the contemporary secondary literature that the pro revenue doctrine was anything but a legitimate exercise of judicial power.

\textit{2. The Legitimation of the Pro Revenue Rule of Construction}

The pro revenue rule of tax interpretation is therefore not a case of judicial complicity in the imposition of central government power over the cries of a dissenting general public. Why, then, did this community, which was in the process of embracing the values of a liberal legal order and formalist interpretative methodologies with respect to other legislation, treat the pro revenue construction of tax legislation as unremarkable? In the ordinary course of events it would be usual to consider the judgments of the courts in attempting an answer to this question. In the context of eighteenth century tax interpretation, however, the dearth of case reports containing detailed judicial reasoning eliminates this avenue of research. But a study of judicial reasoning is not the only means of answering the question posed above. An alternative approach is to construct an understanding of the eighteenth century judicial mind by locating the judiciary within their social context. By locating the judiciary within their social context, it is possible to construct an explanation of why the pro revenue approach seemed to be the ‘natural’ approach from the

perspective of the contemporary mind. The dearth of tax decisions\textsuperscript{181} may therefore be a positive benefit in that we are compelled to adopt an alternative mode of historical inquiry, examining the linkage of the tax judgments with the social milieu of the eighteenth century. Thus while I have argued that the judiciary was not captured by the executive arm of government, this is not to say that the judiciary was autonomous from its social context.

In chapter one it was noted that one part of the mainstream account of tax interpretation suggests that tax legislation is in a special category of legislation because it overrides the property rights of the individual for the benefit of the state. This account emphasises the status of individual property rights by suggesting that such penal legislation should be interpreted restrictively, so that the rights of individual subjects are preserved to the fullest extent possible within the law. This emphasis upon the penal nature of tax legislation downplays the rationalisation of the perceived necessity of taxes. The emphasis is upon the rights of the individual rather than upon the perceived necessity of funding a state created to supervise the liberal 'justice' of the emergent political order after 1688. If the penality of taxes and the need to protect individual property rights from such penal impositions is accepted, the strict construction rule is an appropriate interpretative rhetoric. On the other hand, if the need to assure the survival of the state is accorded a predominant role, it might be expected that the strict construction rhetoric will at least be moderated by an interpretative discourse which acknowledges the need to assure the revenue base of the state. It is this latter aspect of tax legislation which was implicit in the eighteenth century tax policy literature. Although it cannot be doubted that the confiscatory nature of taxes was accepted, the tax policy literature of the day did not dwell upon the penal aspect of taxation. Instead, the literature moved on to

\textsuperscript{181} Owing to the general absence of a right of judicial review with respect to most taxes in the eighteenth century; see at nn 74-75 above.
various elaborations of how the revenue of the state might most equitably be raised.

This acknowledgement of the link between the survival of the state and the collection of revenue leads to an alternative account of eighteenth century tax interpretation. This alternative account suggests that the legitimacy of the pro revenue rule of construction adopted throughout the eighteenth century may be reconciled with the emergence of a liberal political order. On this view, the pro revenue rule of interpretation arose out of the generally accepted perception that the survival of the emerging liberal state had to be assured, even if this meant that the rhetoric of individual property rights was tempered in particular circumstances. One key aspect of this account is the proposition that a significant part of the eighteenth century English community accepted, for any one or more of a number of reasons, that the survival of the fledgling 'democratic' state depended upon its ability to raise taxes. This raises the question of why the survival of the new state was perceived as 'good' from the diverse standpoints of members of the eighteenth century English community? Of course, any attempt to answer this question must be framed in terms of broad generalisations. But having acknowledged the shortcomings of such inescapable generalisations, I will proceed to a consideration of why at least some significant segments of the eighteenth century English community might have believed that they had a vested interest in the survival of the new political order, such that they could then quite logically have acceded to the pro revenue construction of tax legislation as a legitimate exercise of judicial power.
3 The Political Power of the Landed and Moneyed Classes

The Restoration of Charles II to a throne bereft, in at least a practical sense, of much of its former power, confirmed the authority of the landed and commercial interest. The Navigation Acts, the dismemberment of feudal work relations by statute and by statutory interpretation, the abolition of feudal tenures except copyhold, the restriction upon the movement of the poorer classes embodied in the Act of Settlement of 1662 and the enclosure of common lands are but part of a larger picture of a society no longer drawn more or less along feudal lines but upon the creed of private property. Whilst the landed and moneyed interests were not necessarily identical, it has been suggested that the achievement of Walpole in the early eighteenth century was to reconcile these conflicting factions of the Whig party in maintaining the Whig control of Parliament. For much of the eighteenth century, it has been argued, there was a Whig oligarchy which laid the foundations for an era in which it was readily accepted that Parliament largely represented the understanding of the national interest projected by the landed and moneyed interests. The eighteenth century, then, was a period in which those few who satisfied the threshold of the property franchise and were therefore directly represented in Parliament would most clearly have had a vested interest in the preservation of the fledgling ‘democratic’ state.

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182 The loss of the king’s power, in practical terms, to impose taxes without the consent of Parliament and the erosion of the king’s other sources of revenue (such as the abolition in 1646 of feudal tenures and the Court of Wards) was critical in this regard.
183 Hill, above n 65, 174.
184 The effect of which was to allow the private appropriation and enclosure of the common lands, Hill, above n 65, 177; P Styles, ‘The Evolution of the Law of Settlement’ (1963) 9 University of Birmingham Historical Journal 33.
185 JH Plumb, Sir Robert Walpole (1968); noted in Hill, above n 65, 218.
187 Brewer, above n 43; Langford, above n 7, ch 5.
4 The Financial Interest of the Landed and Moneyed Interests in the New Order

The landed and moneyed classes also had a direct financial interest in the maintenance of the state after the Restoration. The abolition of feudal tenures (except copyhold)\textsuperscript{188} in 1646,\textsuperscript{189} and the development of the strict settlement in the 1640's, allowed the propertied to bequeath their estates to the first male heir, but meant that many other male offspring of the propertied classes were compelled to pursue their fortunes in the government service.\textsuperscript{190} Furthermore, the financing of wars by raising considerable loans, made by the propertied classes on the security of taxation revenue, was significant in allying the central government with those with property and/or commercial wealth.\textsuperscript{191}

While the emergent political order after 1688 clearly advantaged many of those with property, it is doubtful that the landed and moneyed classes adopted a purely self interested standpoint in maintaining their support for the new state. The so-called Glorious Revolution of 1688 marked a critical phase in the development of the ideology of the rule of law. The earlier abolition of feudal tenures, the abolition of arbitrary taxation and the entrenchment of parliament as the lawmaking authority were perceived as a victory not only for the propertied classes, but for all born under the ideology of the 'free born Englishman'.\textsuperscript{192} This essentially peaceful revolution was, in the eyes of the propertied classes, a victory for the best of possible worlds in which individual enterprise would be rewarded and the fruits of such enterprise would be protected by the state.\textsuperscript{193}

\textsuperscript{188} For a discussion of the significance of the abolition of feudal tenures see: HJ Perkins, 'The Social Causes of the British Industrial Revolution' (1968) 18 Transactions of the Royal Historical Society, Fifth Series, 123.

\textsuperscript{189} This abolition was confirmed in 1660 by (1660) 12 Charles II, c 24.

\textsuperscript{190} Hill, above n 65, 147, 148.

\textsuperscript{191} Ibid 184.

\textsuperscript{192} See: Daniel Defoe, True Born Englishman, quoted in Holdsworth, above n 66, vol 6, 61 n 1.

\textsuperscript{193} Locke, above note 7, passim.
5 The Significance of the New State to the Lower Classes

Even to the lower classes, there were good reasons for accepting that the preservation of the parliamentary state was in their interests. It cannot be doubted that there was a systematic and even at times brutal oppression of dissenting voices by the Whig oligarchy of the eighteenth century. But this does not mean that the lower classes were merely oppressed, powerless and mute before the Whig juggernaut. Thompson and others have described the tradition of dissent and the rhetoric of the rule of law which underpinned the construct of the ‘free born Englishman’. Whilst noting that the freedom was largely for male Protestants of property, Corrigan and Sayer have traced the popularisation of the association of the emergent state and a ‘government for all’ rhetoric. The ideology of individual freedom ushered in by the emergent liberal state therefore promised a new era of rights, self respect, personal dignity and individual responsibility to the labouring poor. As Porter has noted, there were enough ‘promises of ambition, self respect, new enjoyments, polite values and fashionable lifestyles’ to induce many in the lower orders to believe that the new state was for the best. The rights discourse of liberal individualism was therefore not solely the tool of the ‘ruling class(es)’, but was also relied upon by the lower classes in advancing their own claims for political representation, property rights and the protection of the state. It is therefore understandable that the formal equality promised by the rule of law rhetoric appeared attractive not only to the ‘true’ Whig constituency, who perhaps stood to gain most from the freedom of capital and person prescribed by possessive individualism, but to a far wider portion of the community emerging from feudal ties.

195 Ibid.
196 Philip Corrigan and Derek Sayer, The Great Arch: English state formation as cultural revolution (1985).
The eighteenth century also saw the continuation of a state legitimated in part by a Manichean discourse of national identity contrasted with foreign cultures.\textsuperscript{198} This discourse is apparent in the wide recognition of the 'free born Englishman', no Popery populism,\textsuperscript{199} fears regarding the survival of the Hanoverian succession, and the empire building inherited from Tudor times and furthered during the eighteenth century by the prosecution of numerous wars. This unifying national discourse was sponsored by the state and tended towards the legitimation of the state as the representative of one national identity. Whilst this discourse of unity never achieved totality, it was nevertheless a significant element of the acceptance of the Whig state by a diverse range of people across the social spectrum, rather than just the ruling Whig oligarchy.\textsuperscript{200}

Of course, none of the foregoing discussion warrants the conclusion that significant parts of the eighteenth century English community would tolerate any measures designed to assure the survival of the new political order. The fear and loathing of state intrusion is all too apparent wherever one turns in examining eighteenth century England.\textsuperscript{201} What this discussion suggests, however, is that this fear and loathing was substantially tempered by a widely accepted belief that the survival of the state was essential, subject to appropriate checks being imposed upon state power.

\textit{6 Threats to the New State}

This brief account of the reception of the new political order within the eighteenth century English community goes some way to explaining why the

\textsuperscript{198} Corrigan and Sayer, above n 196.
\textsuperscript{199} Thompson above n 195.
\textsuperscript{200} Corrigan and Sayer, above n 196, passim.
\textsuperscript{201} The work of John Locke (above n 7) and Adam Smith (above n 39, 845-6) illustrates the point that state power was constrained to some extent by public opinion regarding the 'proper' degree of state interference in daily life. In the context of taxation, the abolition of the hearth tax owing to popular resentment is one clear example of the importance of public opinion in shaping tax policy.
pro revenue rule of construction was accepted by the courts in the eighteenth century. If the new liberal political order was perceived by at least some significant segments of the English community as the best of possible worlds, then it is understandable that the judiciary would seek to assure the survival of that order. However, over the course of the eighteenth century there was a more urgent reason for the insistence of the judiciary that tax legislation be interpreted in favour of the Crown. The new liberal political state faced dissent from within while simultaneously waging war with foreign powers for much of the eighteenth century. It is therefore appropriate to briefly review the nature of some of the more significant threats to the new state before drawing some conclusions regarding the interpretation of tax legislation.

7 Social Unrest

Notwithstanding the power of the unifying discourse of one national identity, it is clear that the English society of the seventeenth and eighteenth centuries was anything but a harmonious world in which all acquiesced in the new order of the Whig oligarchy. The ideology of freedom and the rule of law, which brought the landed and moneyed classes to political power, also spawned an undercurrent of dissent which threatened the legitimacy of their rule. The rhetoric of rights found, for example, in Locke’s *Two Treatises on Government* not only served to rationalise the revolution of 1688 to the new ruling classes, but resonated with the calls for individual rights of dissenters such as Tom Paine in his *Rights of Man*. Attempts were made to stifle such dissent by enforcing the law with respect to seditious libel and also by less direct means such as the imposition of stamp duties upon pamphlets and

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202 An aspect more closely examined by Corrigan and Sayer, above n 196, ch 4.
203 Above n 7
newspapers from 1712. Whether or not these measures were effective, they are indicative of the sense of insecurity felt by at least some of those with a vested interest in the new state. This sense of insecurity was doubtless fuelled by periods of social unrest and riot, which arose with sufficient frequency throughout the eighteenth century to remind those with a direct say in Parliament of the threat to their power posed by an organised revolt.

This sense of insecurity was not a new experience for the English. It has been suggested that there were more internal disturbances in England in the period 1450 to 1640 than in any other European country. During the course of the eighteenth century the threat of social revolution remained. Rude identified 275 uprisings in the period 1735 to 1800. Although it has been noted that the selection of this period produces a distorted picture, as it ignores the relative calm of the preceding seventy years. Nevertheless, it is significant that over the period in which the courts had jurisdiction to hear appeals on the window tax, 'the mob' was never far from popular consciousness. Over the eighteenth century there were numerous causes pursued by 'the mob' including the religious fervour of 1688, the Gordon riots of 1780, the mechanisation of industry, turnpikes, enclosures of common lands, high grain prices and other incidents of an economy undergoing dramatic change. In London there were major riots in 1688, 1710, 1715, 1733, 1736, 1753, 1768 and 1780. In

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206 (1711) 10 Anne c 19 (An Act for laying several Duties upon all soap and paper ...) (Eng), s 111; the effect of this measure would, no doubt, have been to reduce the circulation of newspapers and pamphlets catering for the lower classes.
207 Pitirim Sorokin, noted in Hill, above n 65, 119.
209 Holmes and Szechi, above n 186, 173.
211 Other riots at least partially founded upon religious prejudice included the Sacheverell riots of 1710, the riots of 1715-1716, and the riots concerning the Jewish Naturalisation Bill of 1753; see: G Holmes, 'The Sacheverell Riots: The Church and the Crowd in Early Eighteenth-Century London', (1976) 72 Past and Present 55.
212 Hill, above n 65, 265-6.
1766 alone there were twenty four riots against high prices. Such social unrest may seem trifling to modern eyes as there was no social revolution on the scale of those which occurred in France in 1789 or Russia in 1917. But the eighteenth century cannot, by any stretch of the imagination, be described as one of social peace.

The psychological impact of recurrent periods of social unrest can only have been heightened by a government which could be anything but authoritarian. The means by which the ‘ruling class’ retained power in Britain has been the subject of considerable speculation, given that the state did not have the resources of a political police such as existed in France. Certainly, for much of the period currently under review, the military was at least technically available to quell any social disturbance at the request of the local justice. But for a host of reasons eighteenth century Britain was far from an authoritarian regime in which there was an overt confidence in the power of the state. There certainly was a ruling oligarchy for much of the eighteenth century, but it cannot be said to have ruled in complete disregard of public opinion and without fear of being overthrown by the ‘lower sort’. The relative stability of the English political system during the eighteenth century is arguably attributable to considerable flexibility exercised at all levels of government, thereby moderating to some extent the impact of government policies and reducing the prospect of dissent. But such flexibility is as much the mark of governors insecure in their position as it is of a stable political system.

214 Thompson, above n 195, 66.
215 Hill, above n 65, 266.
216 Holmes and Szechi, above n 186, 179.
217 Cf Atiyah, above n 62, 23.
218 See, for example, Hay, above n 160, 49ff; Thompson above n 180, 264ff.
219 See the Riot Act of 1714 (1 Geo I, Stat 2, c 5); see: Holmes and Szechi, above n 186, ch 12; in the riots of 1780 285 rioters were killed by the military and a further 25 were subsequently hanged.
220 See the material cited at nn 55-57 above.
8 The Weakness of the Taxation System

The demands of financing various wars during the eighteenth century cannot be underestimated in any discussion of taxation history. England was formally at war for 63 of the 126 years spanning 1689 to 1815.\(^{221}\) The strain of funding such wars is apparent in the fact that military expenditure in periods of war often exceeded three quarters of total government expenditure, while peace time levels of military expenditure were generally in the range of 30-40% of total government expenditure.\(^{222}\) It would therefore be reasonable to expect that the central government endeavoured to maximise taxation revenue, not only by introducing a diverse array of taxes, but also by seeking an efficient tax administration.

An effective tax administration in the eighteenth century would have required, at the least, efficient administrators at all levels of the tax administration, administrative powers adequate to the fulfilment of the administrative function and adequate central supervision of the local tax administration. Unfortunately, the evidence suggests that none of these critical factors was present throughout the eighteenth century.\(^{223}\) From the top down the revenue was subjected to what, even according to the standards of the time, can only be described as extraordinary abuse. At the legislative level the success of revenue bills in parliament was often motivated by the desire of parliamentary factions to maximise opportunities for tax evasion in their respective regions.\(^{224}\) At the administrative level, for most of the eighteenth century the power of the central government was restricted by a lack of resources and by the medieval concept of

\(^{222}\) Ibid 2.
\(^{224}\) Smith above n 39, 828; Beckett above note 53; Langford above n 7, ch 5.
public office which fostered a corrupt and inefficient administration.\footnote{Holdsworth, above n 66, vol 10, 512ff.} As we have seen, responsibility for the administration of the assessed taxes was left to the local government with what can only be described as inadequate central supervision. Whether or not the vast majority of local administrators performed their duties in a professional manner, the evidence is more than sufficient to suggest that there was a generally held belief that the local administration of parliamentary taxation left something to be desired, and that there was little that the central revenue office could do about it.\footnote{O'Brien, above n 221, 3-4; United Kingdom, House of Commons, 1st and 2nd Reports of Select Committees on Illicit Practices to Defraud the Revenue, Parliamentary Papers, First Series, 1783, vol 11, 228, 263, 282.} Further, even where taxes were administered directly by a relatively efficient centralised bureaucracy, as was the case with customs and excise duties, evasion existed on what can only be described as a massive scale. It has been suggested that the trade statistics for the eighteenth century are inaccurate as smuggling may have added between 15 and 20\% to the import figure.\footnote{Holmes and Szechi, above n 186, 149. For detailed discussion of the size of tax evasion in the form of smuggling see: C Winslow, ‘Sussex Smugglers’ in Hay, Albions Fatal Tree, above n 160, 119-166; United Kingdom, House of Commons, Report from the Select Committee appointed to inquire into the Frauds and Abuses of the Customs, to the prejudice of Trade and the diminution of the Revenue, (1733), Parliamentary Papers, First Series, vol 1, 601; United Kingdom, House of Commons, Report from the Select Committee Appointed to Inquire into the Practice of Smuggling (1745) Commons Journal, vol 25, 101-110; see also: William Phillips, ‘The Smugglers’ [1966] British Tax Review 28.} In 1784 it was reported that there were armed cutters deployed by smugglers in flagrant defiance of the customs service.\footnote{United Kingdom, House of Commons, Report upon Illicit Practices in Defrauding the Revenue and the most effectual methods of preventing the same, Second Report, 1783, Parliamentary Papers, First series, vol 11, 263.} The tax system of eighteenth century Britain was, neither by modern nor contemporary standards, a model of efficiency.
Conclusion: Reconciling the Pro Revenue Construction with a Rhetoric of Rights

The first problematic feature of eighteenth century tax interpretation is the tardy and piecemeal recognition of a role for the courts in tax administration, in apparent disregard of the dictates of liberal political theory purportedly embraced by eighteenth century England. The second problematic feature of eighteenth century tax interpretation is that the courts apparently rejected the emerging ideology of individual rights by adopting a pro revenue rule of construction. Only by having regard to the wider social context of the eighteenth century English community is it possible to reconcile these problematic aspects of the interpretation of tax legislation in the eighteenth century with the emergence of a liberal political order.

The commitment of a substantial part of the eighteenth century English community to the new political order, which embodied the aspirations of many to a country in which the liberal values underpinned social life, cannot be underestimated. The tyrannical potential of state power and the importance of the taxing power to the state had been etched upon the British mind during the seventeenth century. Rising out of the ashes of the constitutional conflicts of the seventeenth century, the eighteenth century understanding of English constitutional law was of a finely balanced system of checks and balances founded upon the separation of powers between the central and the local branches of government, the executive, the legislature and the judiciary which ensured the protection of the rights of the individual. But this recognition of the existence of individual rights, and the role of the state in fostering the social environment in which those rights might flourish, was problematical. The apparent contradiction between individual and state was resolved by accepting

229 Montesquieu, above n 39. For consideration of the significance of Montesquieu's understanding of the English constitution to eighteenth century English consciousness see: Holdsworth, op cit (n 66), vol 10, passim.

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that in some cases individual rights might have to be compromised in order to assure the existence of what was understandably perceived at the time to be a fragile political order. Thus, in each case where the perceived rights of the individual were threatened, the perceived importance of those rights was balanced with the need to assure the existence of the state.

England's blue water defence strategy placed significant demands upon the taxation system at a time when there could have been little confidence in the ability of that system to raise the necessary revenue in an efficient manner. From the perspective of those at the centre of government, the tax administration needed all of the assistance that could be mustered in bringing in the revenue. In the face of continuing threats to the survival of the new social order posed by the perennial threat from foreign powers, widespread and frequent social unrest and widespread tax avoidance and evasion, it was understandable that the central government would select the most efficient means of raising revenue which was tolerable to the community. In the case of taxes under the control of what was perceived to be a relatively efficient central administration, such as excise and customs, it was considered that there was no need for judicial review and, further, that judicial review would only constitute an impediment to the efficient administration of those taxes. By contrast, in the case of those taxes administered by what was perceived to be a relatively inefficient local administration, the combination of judicial review and the pro revenue construction of tax legislation were legitimated as one means of supplementing the weak control of the central government wielded through the Tax Office and the Treasury. In this context it is understandable that, when granted a jurisdiction to hear substantive tax matters, a judiciary acquainted with the political theory of Hobbes and Locke accorded central importance to the survival of the state in maintaining some semblance of social order. This interrelationship between the fiscal viability of the state, compliance with the law, the maintenance of the rule of law and the survival of the 'new' political
order was captured in 1783 by the House of Commons Committee appointed to inquire into the frauds upon the revenue:

It farther deserves remark, that enormities of such violence and extent amount to a partial state of anarchy and rebellion, and have a tendency to weaken and impair every idea of a regular government, and all due submission to the laws of the land.\textsuperscript{230}

It is for this reason that, despite the English psyche being deeply imbued with a rights rhetoric, the courts and the legislature adopted the apparently contradictory approach of often ignoring their usual concern for the protection of private property in order to save the political order which promised so much for individual rights generally. Far from the eighteenth century being a period of strict construction of tax legislation by the courts, it was a period in which tax administration was dominated by pragmatic concerns. The exclusion of the courts from hearing disputes regarding the most important taxes of customs and excise, and the pro revenue rule of construction, typify the pragmatism that pervaded the legal domain of that period.

\textsuperscript{230} United Kingdom, House of Commons, \textit{Report upon Illicit Practices in Defrauding the Revenue and the most effectual methods of preventing the same}, First Report, 1783, Parliamentary Papers, First series, vol 11, 228, 229.
CHAPTER THREE - INTERPRETATION OF THE INCOME TAX IN VICTORIAN ENGLAND

A Introduction

From the preceding chapter it may be seen that it was not until the early nineteenth century that the first signs of a formalist interpretative rhetoric were adopted by the courts when interpreting tax legislation. According to this rhetoric, the courts concentrated upon discovering the objectified and determinate literal meaning of tax legislation without any regard to the consequences of their decisions or the contexts in which those decisions were enforced.¹ This interpretative rhetoric of the courts was adopted by the commentators, such that the strict construction rule assumed an axiomatic status by the mid nineteenth century. The mainstream account of tax interpretation therefore maintains that there is no clearer example of a literalist interpretative methodology than the interpretation of tax legislation in the nineteenth century.²

There are three key elements within this mainstream account of nineteenth century tax interpretation. The first is that there was one determinate literal meaning of tax legislation which was discoverable by the judiciary in the process of resolving tax disputes. The second is that there was a uniform understanding of the literalist approach to statutory interpretation, and that approach was not only the dominant, but the only method of tax interpretation adopted by the courts of the United Kingdom in the nineteenth century. The

¹ Partington v Attorney-General (1869) LR 4 HL 100; The Queen v Judge of City of London Court [1892] 1 QB 273, 301-302.
² D Williams, 'Taxing Statutes are Taxing Statutes: The Interpretation of Revenue Legislation' (1978) 41 Modern Law Review 412; Sir A Mason, 'Taxation Policy and the Courts' (1990) 2 The CCH Journal of Australian Taxation 40, 41-2; JA Corry, 'Administrative Law and the Interpretation of Statutes' (1935) 1 University of Toronto Law Journal 286, 296, although Corry does not deal specifically with revenue legislation; H Monroe, 'Fiscal Statutes: A Drafting Disaster' (1979) British Tax Review 265, 265; D Goldberg, 'Your Subjects Inherited What Freedom?' (1975) British Tax Review 87, 87; where Goldberg implies that the strict construction rule may be traced back to the Petition of Right 1627 3 Car 1, c 1, s 1; R Stevens, Law and Politics (1979) 100-101.
purpose of this chapter is to consider whether these propositions comprise an accurate depiction of the judicial interpretation of tax legislation in the nineteenth century.

For the purpose of this chapter the judicial interpretation of the British income tax legislation in the last decades of the nineteenth century will be examined. According to the generally accepted historical account of tax interpretation, the income tax legislation was predisposed towards a literal interpretation by the courts. The British income tax legislation generally divided assessable receipts according to their source. With respect to each category of receipts, the legislation incorporated a schedule of specific rules (referred to as 'Cases') governing the assessability of the relevant category of receipts. By specifically enumerating the categories of taxable receipts rather than expressing a general concept of income, it has been suggested that the legislature induced the courts to adopt a literal interpretation of each item on the schedular checklist, without giving any consideration to an overarching concept of income. As a result, the courts merely determined whether a particular receipt fell within the literal meaning of any of the statutory Schedules, paying no heed to more general considerations such as the legislative intention or policy considerations. Thus, if the interpretation of tax legislation during the nineteenth century was emblematic of the literalist methodology, there was purportedly no clearer case of a literalist interpretation of tax legislation than the interpretation of the income tax in Victorian England. A case study of the judicial interpretation of

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4 The differentiation of income according to its source reflected the differentiation of income adopted in eighteenth century tax policy literature; see, for example, Adam Smith, *An Inquiry into the Nature and causes of the Wealth of Nations*, R H Campbell, A S Skinner, W Todd (eds), (1976), vol ii, 817-906.
the Victorian income tax is therefore a logical choice in considering whether the mainstream portrayal of tax interpretation is accurate.

**B The Introduction of the Income Tax**

In chapter two it was noted that the eighteenth century tax policy literature reflects the general concern to shelter the lower classes from the growing burden of taxation required to fund British foreign policy. Successive governments therefore experimented with taxes upon 'luxury' goods until the indirect tax system was stretched to what was considered to be its capacity to yield additional revenue. After 1747 additional revenue was raised by a variety of direct taxes upon such items as silver plate, carriages and hair powder. The desperate scramble for additional government revenue culminated in the composite expenditure/income tax of the 'Triple Assessment' in 1798, a tax which promised more revenue than it ultimately delivered. The Triple Assessment imposed additional tax upon a taxpayer according to the amount of tax paid on their expenditure in the previous year, although the amount of tax payable was limited to ten per cent of the taxpayer's income. The inability of a threadbare direct tax administration to cope with the considerable administrative

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5 There is a substantial body of research concerning the introduction of the English income tax in the era of the Napoleonic wars and so the circumstances of the introduction of the tax will only be briefly outlined here. For further information concerning the early income tax see: A Hope-Jones, *Income Tax in the Napoleonic Wars* (1939); A Farnsworth, *Addington, Author of the Modern Income Tax* (1951); E R A Seligman, *The Income Tax: A Study of the History, Theory and Practice* (2nd ed, 1914). It should be noted that these accounts regarding the income tax during the Napoleonic have been corrected in several important respects: William Phillips, 'A New Light on Addington's Income Tax' [1967] *British Tax Review* 271. For a more general history of the income tax see: Stephen Dowell, *A History of Taxation and Taxes in England* (3rd ed, 1965).

6 (1798) 38 Geo III, c 16 *(An Act for granting to His Majesty an Aid and Contribution for the Prosecution of the War)* (Eng).

7 Pitt had predicted that the tax would raise four and a half million pounds, when in fact it raised less than two million pounds; United Kingdom, *First Report from the Select Committee on the Income and Property Tax*, (House of Commons Papers, Session 354, 1852, vol 9, 3; United Kingdom, *Report of the Commissioners of Inland Revenue* (1870) 120.
supervision necessary in scrutinising taxpayers' claims concerning their respective incomes precipitated its demise.\(^8\)

The one constant throughout this period was the resistance to the introduction of an income tax, primarily upon the basis that such a tax constituted an intrusive and non voluntary imposition which contravened the fundamental rights of the free born English person.\(^9\) Even in 1792, Pitt observed:

> If the amount of every man's property could be ascertained, it would be a most desirable thing to make the people contribute to the public exigence in proportion to their wealth. But there existed no means of ascertaining the property of individuals, except such as were of a nature not to be resorted to.\(^{10}\)

Notwithstanding these earlier reservations, just six years later the dire need for additional revenue to finance the war with Napoleon forced Pitt to adopt what was considered to be the extreme measure of an income tax in a context where there was no successful precedent\(^{11}\) of such a tax. The sense of desperation is almost palpable in the record of Pitt's speech to the House of Commons upon the introduction of the income tax bill.\(^{12}\) Venting his frustration at the considerable evasion which had undermined the various expenditure taxes, Pitt expressed the hope that the introduction of the income tax would usher in a new

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\(^8\) Note that, while the permanent establishment of the revenue arm of government had grown dramatically in the eighteenth century, the preponderance of staff were concentrated in collecting the customs and excises; see: John Brewer, *The Sinews of Power* (1989) Tables 3.2, 3.3, 66-7.

\(^9\) An early instance of this resistance to 'intrusive' taxes may be seen in the repeal of the hearth tax: (1662) 3 & 4 Car II, c 10 (*An Act for Establishing an additional Revenue upon his Majesty...*) (Eng); repealed by (1688) 1 Will & M, c 10 (*An Act for Taking away the Revenue arising ...*) (Eng).


\(^11\) Note that the long running land tax of (1692) 4 Will and Mary c 1 had included a tax upon various categories of income and personal wealth, but owing to the shortcomings of the local administration, the tax had generally only been imposed upon landed wealth; BEV Sabine, *A History of Income Tax* (1966) 16.

\(^12\) United Kingdom, *Hansard*, House of Commons, 3 December 1798, vol 34, coll 1-6.
era of fiscal success. Taxing income, he suggested, would overcome tax evasion by compelling people to pay tax upon receipt of income rather than upon expenditure.

The income tax was less than successful in overcoming this problem of tax avoidance in its first years. However, after key amendments to the structure of the legislation and the administration of the tax, it proved to be relatively successful in raising much needed revenue during the period of the Napoleonic wars. Nevertheless, there is considerable evidence of widespread evasion of the tax, particularly by the business community.

The early income tax was widely perceived as a particularly onerous measure, justified only because of the unique exigencies of the war. At the cessation of hostilities the income tax was the subject of widespread public hostility and it was allowed to lapse shortly thereafter. From 1815 until 1841 the income tax was allowed to lay dormant. The accession to power of Peel’s Conservatives on a platform of free trade once again precipitated a need to find additional sources of revenue to replace the foregone customs revenue. The government dusted off the income tax of the Napoleonic wars and reintroduced it in substantially the same form, albeit as a temporary measure. From 1842 the ‘temporary’

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13 Ibid.
14 Cf Margaret Levi, Of Rule and Revenue (1988) 140. Pitt had estimated that the income tax would raise £10,000,000 in its first year of operation, when in actual fact it raised just £6,000,000. For the 1801 year Pitt estimated that the tax would raise £6,000,000, when in actual fact it raised just £5,300,000. For discussion of the income tax yield in these early years, and the specific shortcomings of the tax, see: Farnsworth, above n 5, 18-26.
15 The Income Tax Act 1803 (Eng) 43 Geo III, c 122; Addington’s most significant alterations were the introduction of the schedular categorisation of various forms of income and also the introduction of withholding of tax by a payor on behalf of the payee with respect to payments of interest, dividends, rent, income from investment funds and emoluments of Crown servants. For studies of the introduction of the income tax by William Pitt in 1799 and its modification by Henry Addington in 1803, see: A Farnsworth, above n 5; A Hope-Jones, Income Tax in the Napoleonic Wars (1939); Meade Emory, ‘The Early English Income Tax: A Heritage for the Contemporary’ (1965) 9 American Journal of Legal History 286.
16 Hope Jones, above n 15, 117-8.
17 Ibid, ch 7.
18 Sabine, above n 11, 42-5; Levi, above n 14, 140-3.
income tax was renewed in order to meet the fluctuating demand for additional revenue arising from war, indirect tax reductions and the vicissitudes of government revenue.\textsuperscript{20} By the last decade of the nineteenth century even those most opposed to the income tax had come to accept that fiscal circumstances dictated the retention of the tax.\textsuperscript{21} Although there were some amendments over this period, the income tax legislation throughout the Victorian era was largely unchanged from the legislation comprising the \textit{Income Tax Act 1842}\textsuperscript{22} as amended by the \textit{Income Tax Act 1853}.\textsuperscript{23} Indeed, the form of the Act was in many respects identical with Addington's 1803 revision of the legislation first introduced by Pitt.\textsuperscript{24} Even in the 1930's one commentator suggested that little had changed since the introduction of Pitt's income tax.\textsuperscript{25}

The long title of the Act stated that it was 'an Act for granting to Her Majesty duties on profits arising from property, professions, trades, and offices.' There were five Schedules dividing the profits referred to in the preamble into categories to which differing rules of assessment would apply. Within each Schedule there were specific rules dealing with particular 'Cases' of the form of income dealt with by the Schedule. The taxable 'profits' were divided according to the source of the income. Thus Schedule A applied to profits arising from the ownership (legal or beneficial) of real property, Schedule B generally applied to


\textsuperscript{20} For a history of the income tax explaining its survival despite repeated election campaigns conducted on the basis of abolition of the tax, see: Sabine, above n 11, chaps 6 and 7.

\textsuperscript{21} Ibid, 109-11.

\textsuperscript{22} \textit{The Income Tax Act 1842} (Eng) 5 & 6 Vict, c 35. It should be noted that this Act was only given a short title in 1892 by the \textit{Short Titles Act 1892} (Eng) 55 Vic c 10, s 2. The long title to the Act was 'An Act for granting to Her Majesty duties on profits arising from property, professions, trades, and offices, until the Sixth Day of April One thousand eight hundred and forty-five'.

\textsuperscript{23} \textit{The Income Tax Act 1853} (UK) 16 & 17 Vict c 34. It was only after the passing of this Act that income tax was payable in Ireland. Once again, it was only by the \textit{Short Titles Act 1892} that this Act received a short title. The long title to the Act was similar to that of the 1842 Act, viz 'An Act for granting to Her Majesty duties on profits arising from property, professions, trades, and offices'.

\textsuperscript{24} Although Shehab notes that there were some relatively minor alterations to the earlier legislation; F Shehab, \textit{Progressive Taxation} (1953) 86.
the annual value of occupied land not already taxed under Schedule A (except, *inter alia*, dwelling houses) and therefore primarily imposed a tax upon farmers with respect to their farming profits (although the quantum of those profits was deemed to be a fixed proportion of the rent paid for the land). Schedule C applied to various classes of 'unearned' income such as interest and annuities. Schedule E assessed various categories of income and, independently, profits, derived by the taxpayer from public office. Schedule D applied to income from trade and professions and included a 'catch-all' provision whereby 'any annual profits or gains not falling under any of the foregoing cases and not charged by virtue of Schedule A, Schedule B, Schedule C or Schedule E' would be subjected to income tax.

**C One Income Concept?**

1 *The Relevance of the Income Concept to the Interpretation of ‘Profits and Gains’*

From the preceding discussion it may be seen that the operative provisions of the income tax legislation had always referred to 'profits' and 'gains'. According to the generally accepted account of tax interpretation, the courts of the nineteenth century adopted the strict literal meaning of 'profits' and 'gains' in applying the income tax legislation. As this account of tax interpretation is clearly founded upon the proposition that there was one generally accepted meaning of the legislative terms, it is appropriate at this point to consider whether the meaning of 'profits and gains' was as unproblematic as the mainstream account of tax interpretation would suggest.

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Notwithstanding the references to ‘profits and gains’ in the operative provisions of the Act, they were generally understood to impose a tax upon ‘income’.26 This understanding was reinforced when the title of the legislation was belatedly changed in 1892 to the Income Tax Act.27 The Oxford English Dictionary indicates that the first recorded use of the word ‘income’ in the English language may be found in 1603.28 It might therefore be thought that a word of such long standing in English usage, with such a relatively straightforward definition, might have been a relatively unproblematic keystone to the income tax. Indeed, when introducing the Income Tax Bill into the House of Commons, Pitt seemed to assume that the income concept was well understood, as Cobbett’s report of Pitt’s speech suggests that no consideration was given to the nature of that concept.29

2 The Income Concept in Nineteenth Century Britain

Had there been a generally accepted understanding of income in the nineteenth century British community, it might have been expected that that understanding would have attracted some consideration in the contemporary tax policy literature. In chapter two it was noted that much of the consideration of taxation policy during the eighteenth century was founded upon the view that all members of a community ought contribute to the maintenance of the state in

26 Thus in 1803, in what is understood to be the official explanatory pamphlet accompanying the legislation, *An Exposition of the Act for a contribution on property, professions, trades, and offices; in which the principles and provisions of the Act are fully considered, with a view to facilitate its execution, both with respect to persons chargeable, as persons liable, to the tax by way of deduction, and the officers chosen to carry it into effect*, it was acknowledged that the tax applied to ‘income’, notwithstanding that the operative provisions referred to profits and gains. For discussion of the source of this document see: Sabine, above n 11, 36 n22; see also the evidence of Mr Charles Pressly, Commissioner of Taxes in United Kingdom, *First Report from the Select Committee on the Income and Property Tax; Together with the Minutes of Evidence and Index (Hume Report)* (1852) 8.

27 See: above n 22.

28 Being the work of one R Johnson, *Kingdom and Commonwealth* (1603) 196.

29 United Kingdom, *Hansard*, House of Commons, 3 December 1798 col 4-22 (William Pitt, Prime Minister).
proportion to the benefit that they derived from the existence of the state.  

Further, it was noted that the concept of benefit developed in the eighteenth century focused upon the protection of private property afforded by the state such that the benefit theory of taxation had been reconciled with the imposition of taxation according to the relative wealth of the subject. A range of options for measuring the relative wealth of the subject had been canvassed, from consumption to property to revenue. In the mid-nineteenth century John Stuart Mill rejected the benefit theory of taxation, arguing that the proper maxim was that a fair tax system could only be founded upon equality of sacrifice.  

Although there is some debate about whether this rhetorical shift represented any substantive shift in tax policy, for present purposes it is sufficient to note that neither Smith nor Mill offered a detailed appraisal of the income concept from the perspective of the benefit or ability concepts. They both acknowledged that an income tax had some advantages if it could be tolerated by the public and was properly administered, but arrived at this conclusion without offering any detailed consideration of the income concept. For example, both authors ignored the problem of whether ‘income’ entailed the change in net wealth of the individual over a specified period of time or whether ‘income’ was the flow of fruits from capital assets regardless of any consequent diminution of the capital asset, as in the case of wasting assets.  

This dearth of contemporary literature upon the income concept may be explained by the fact that at the time it was considered that there was no need

30 See the text in chapter two under the heading ‘Eighteenth Century Taxation - Penal Imposition or Payment under (Social) Contract’.  
34 See, for example, Smith’s treatment of interest receipts, where he acknowledges that they are a proper subject of taxation but also accepts that administering the imposition of tax upon interest would be problematic: Smith above n 33, 848-9. Classic examples of the conversion of capital into an income flow being annuities and mining rights.
for any elaboration of the income concept. From the discussion of the local administration of direct taxation in chapter two, it may be seen that the application of taxes upon various forms of income was undertaken with a considerable degree of discretion exercised at the local level of government.\textsuperscript{35} Even when Pitt’s more fully developed income tax was introduced, there is a wealth of evidence indicating that the local administration of the tax subverted any attempts to establish a uniformly applied interpretation of the income concept.\textsuperscript{36} It was therefore generally accepted that the arbitrary administration of direct taxes made any detailed elaboration of the income concept relatively worthless.\textsuperscript{37} Any consideration of the ethical foundations of taxation was therefore ultimately forced to confront a number of pragmatic considerations which played a significant role in shaping the tax policy discussion of the eighteenth and nineteenth centuries. Given that income was conceived in terms of an unrealisable ideal, it is understandable that leading contemporary political economists chose to focus upon the more ‘realistic’, and more fiscally significant, forms of taxation such as customs and excise. The absence of any detailed examination of the income concept was therefore understandably

\textsuperscript{35} See chapter two, pp 10-16.
\textsuperscript{36} See, for example, the evidence presented to the Select Committee on the Income and Property Tax by Mr J Lee (Surveyor of Taxes in Birmingham), \textit{Second Report from the Select Committee on the Income and Property Tax}, above n 26, 397-8; see also the evidence of Mr John Nicholson (Surveyor of Taxes at Manchester) ibid, 361-2.
\textsuperscript{37} For Adam Smith’s dismissal of an income tax upon the basis that it would be difficult to administer see: Smith, above n 33, 867-9. Groves has also noted that the brevity of Mill’s consideration of the meaning of equal sacrifice in the taxation context is attributable to the contemporary view that such a study would be superfluous, as the tax administration would never be in a position to measure sacrifice; Harry Groves, \textit{Tax Philosophers} (1974) 33. With respect to Mill’s preference for a house tax over an income tax, see his evidence presented to the Select Committee on the income tax at: \textit{Second Report from the Select Committee on the Income and Property Tax}, above n 26, 313-4. Even when it was suggested that taxation according to ability to pay mandated the conversion of the income tax to a property tax to enable the more accurate measurement of changes in net wealth of taxpayers, evidence presented to the 1852 Select Committee by the then Commissioner of Taxes was to the effect that the implementation of a tax upon net wealth would be administratively impractical; \textit{Second Report from the Select Committee on the Income and Property Tax}, 245-6 (evidence of Mr Charles Pressly, Commissioner of Taxes). It is for this reason, Groves suggests, that both Smith and Mill opted for a house tax as the most appropriate means of taxing wealth, because the quality of a taxpayer’s residence was taken to be a readily measured indicator of wealth; Groves, 35.
ignored until the income tax began to emerge as a significant source of
government revenue and, conversely, a significant imposition upon taxpayers.\(^{38}\)

However, the absence of any detailed elaboration of the income concept in the
contemporary tax policy literature does not mean that the income concept was
meaningless to members of the eighteenth and nineteenth century English
communities. Rather, there were several irreconcilable concepts of income
applied in different contexts within the nineteenth century English community.
It is therefore necessary to consider the influence of these alternative concepts of
income upon the English income tax legislation.

3 The Fractured Concept of Income Within the Income Tax Legislation

(a) The Equivalence of Income with Gross Revenue Flows

Since Elizabeth I introduced the poor rate the courts had been accustomed to
adjudging cases dealing with the assessment to rates imposed upon the profits of
land.\(^{39}\) In this sense 'profits' had been given a technical legal meaning
indicating the income flow from the land less the expenses of collecting that
flow,\(^{40}\) rather than meaning a gain over historical cost analogous to the
accounting definition of profit (income less a broader range of expenses).

This technical meaning seems to have been incorporated to a varying degree in
Schedules A, B and C. In Schedule A the assessment of the annual value of the

\(^{38}\) Over the course of the nineteenth century the nominal rate of income tax did not rise above
10\% of a taxpayer’s income, the tax being imposed at a flat rate. For much of the nineteenth
century the rate of tax was less than 5\%; Sabine, above n 11, 111-5.

\(^{39}\) Collness Iron Co v Black (1881) 1 TC 287.

\(^{40}\) Ibid; see also the Act of 1601 and (1836) 6 & 7 Will IV c 96, s 1, which provided that ‘no rate
... be allowed ... which shall be made upon an estimate of the net annual value ... that is to say of
the rent at which the same (hereditaments) might reasonably be expected to let ... free from all
rates and taxes ... and deducting therefrom the probable average cost of the repairs, insurance,
and other expenses, if any necessary to maintain them in a state to command such rent.’ See also
R v The Inhabitants of Kingswinford (1827) 7 B & C 236; 108 ER 711.
land was calculated by reference to the gross profits derived from the land, with limited specific provisions granting certain exemptions and allowances. This suggests that the legislature had merely adopted the scheme of assessment from the rating acts, by which the land holder was assumed to generate a profit from the ownership of the land regardless of whether a net profit was actually derived. There is no doubt that this approach was administratively expedient, as it obviated the need for record keeping on the part of landowners, and also minimised opportunities to evade the income tax by inflating expenses. Indeed, a deduction for repairs had been allowed under the income tax of Napoleonic times, but had been repealed in response to evidence of tax evasion. As a result, only limited expenses were expressly allowable as deductions from gross receipts under Schedule A. Under Schedule B, the occupants of farming land were assumed to generate a profit from the land equivalent to a fixed percentage of the rental value of the land. By imposing tax upon a deemed return from the land under Schedules A and B, the legislature therefore adopted a unique concept of income remote from any concept of actual revenue flows or some understanding of the taxpayer's ability to pay the tax, a feature which attracted considerable criticism.

41 In the original act of 1799 a procedure for determining the actual profits from the land was prescribed, but owing to considerable evasion the 1803 legislation set down the assumed rate of return method for determining profits from land; see: Anon, above n 26, 13-14.
42 For parliamentary consideration of this topic towards the end of the nineteenth century see: United Kingdom, Hansard, House of Commons, 19 June 1884, 891-3, (Mr Clare Read); United Kingdom, Hansard, House of Commons, 19 June 1884, 901-2 (Mr Gladstone, Prime Minister); United Kingdom, Hansard, House of Commons, 30 April 1885, 1165-6 (Mr J Hubbard).
43 The deduction was originally allowed under the 1803 legislation, but was omitted in the revised legislation of (1806) 46 Geo III c 65 (Eng). For discussion of this point see: A Guide to the Property Act 46 Geo III with Tables of Calculation, forms of proceeding, cases of illustration, and explanatory notes, taken from the best authorities (1807) 14.
44 For example, under the third paragraph of General Rule V, Schedule A of the Income Tax Act 1842, an allowance in respect of repairs of churches and other buildings was specifically provided.
45 See, for example, J R McCulloch, Treatise on the Principles and Practical Influence of Taxation and the Funding System (1845) 131.
Under Schedule C there was no resort to a deemed rate of return upon capital investment, income tax being imposed upon actual gross 'profits'. Thus, for example, annuities were brought into assessment without any allowance for the diminution of the capital sum comprising the source of the annuity. Although the taxation of gross actual revenue flows might be perceived as some improvement upon Schedule A in terms of equity, the taxation of gross flows without any attention to the 'real' gain derived by the taxpayer from the investment attracted considerable critical comment.46

(b) The Equivalence of Income to Gross Revenue Flows Less Some Expenses

Schedule D generally applied to the burgeoning manufacturing, commercial and service sectors of the economy. Although Schedules A, B and C broadly took actual or deemed gross revenue flows as the foundation for measuring the taxpayer's income, Schedule D allowed a wider range of deductions from 'profits or gains'. Schedule D seemed to reflect an intention to accommodate the 'business interest' by imposing liability upon a different concept of profits closer to some notion of 'actual' profit recognised by the business community. This horizontal inequity between the first three Schedules and Schedule D supports the proposition that there was no general concept of income underlying the legislation.47


47 In the 1852 Select Committee Report this inequity was identified as a significant cause of disquiet amongst the taxpaying community: see, for example, United Kingdom, Second Report from the Select Committee on the Income and Property Tax, above n 26, 48 (evidence of Mr Ebenezer Erskine); 165 (evidence of Mr Francis Neison). The uncertainty as to the nature of the income concept is reflected in the long running debate regarding the differential treatment of 'precarious' and 'secure' incomes. The differential treatment of profits between Schedules A and D may have been linked to the perceived inequity of taxing 'precarious' income from the provision of personal services at the same rate as 'secure' income from property. Thus Gladstone noted that the modes of assessment adopted for the 'secure' income under Schedule A and the 'insecure' income of Schedule D, respectively, incorporated a degree of differentiation
(c) The Equivalence of Income to Net Gains

The reference in Case VI of Schedule D to 'gains not otherwise assessed under the provisions of the Act' might suggest that the income tax was a first, perhaps flawed, attempt to tax some wider notion of 'real economic gain' in addition to the taxation of gross and/or net revenue flows. Such an approach was supported by Pitt's references to income as the proper measure of one's ability to contribute to the commonweal. Further, in the explanatory pamphlet published with the 1803 income tax legislation, it was suggested that the purpose of the tax was to impose a tax liability upon the receipts of a person which constituted his or her income available for 'discretionary expenditure'. One implication of this concept of income was that the income tax would apply both to revenue flows and accretions to wealth which contributed to this 'discretionary expenditure'.

This understanding of 'profits and gains' was consistent with the concept of income increasingly adopted within the commercial community of Victorian...
England. The new industrial age spawned commercial concerns which needed accurate financial information in order to raise finance, determine profit distributions and to conduct business more generally. To cater for this hunger for more accurate financial information, the emergent profession of accounting was developing specific rules governing the measurement of profit for an accounting period. As the nineteenth century progressed, it is clear that the judiciary was prepared to accommodate accounting or business concepts of profits for the purposes of company law. It is therefore understandable that many within the business community argued that the commercial understanding of ‘profits’ ought to be adopted for the purposes of the income tax. Given the rhetoric of ability to pay which attended the introduction of the income tax, and given that accounting practise focused upon ascertaining the true financial position of an enterprise, it was argued that accounting profits equated with the ability of the taxpayer to pay tax. In 1852 some of those presenting evidence before the Select Committee noted that deductions on account of bad debts written off, repairs, depreciation, amortisation, insurance, payments made to

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53 It is beyond the scope of this thesis to examine the development of accounting principles, for a discussion of this subject see, for example, Nicholas Stacey, *English Accountancy: A study in social and economic history, 1800-1954* (1954).

54 Thus in *Davison v Gillies* (1879) LR 16 Ch D 347n Jessel MR accepted that the profits of a company could quite legitimately be calculated after taking into account commercially accepted deductions for items such as depreciation and capital writeoffs. For further discussion of the incorporation of accounting principles into the company law field see: W Strachan ‘The Differentiation of Capital and Income’ (1902) 18 *Law Quarterly Review* 274.

55 Most clearly evidenced by the view that the tax would only apply to the income available for ‘discretionary expenditure’, see: Anon, above n 51; see also Pitt’s speech when introducing the income tax bill; above n 29.

56 Much of this literature arose in the context of the debate concerning the differentiation of precarious incomes from permanent incomes for income tax purposes. See: evidence presented to 1852 Select Committee by Thomas Rowe Edmonds, Actuary of the Legal and General Assurance Office; *Second Report from the Select Committee on the Income and Property Tax*, 1852, above n 26, 122. See also Julius Partridge, *Papers on Taxation: direct and indirect* (1861); see also the work of P Hallett of the Economic Section of the British Association, discussed in Shehab above n 24, 165ff. But cf Richard Krever, ‘Avoidance, Evasion and Reform: Who Dismantled and Who’s Rebuilding the Australian Income Tax System?’ (1987) 10 *University of New South Wales Law Journal* 215 where Krever argues that the ‘science’ of public finance, which advocated the equivalence of income with ability to pay in terms of market power, was only in its infancy until the late twentieth century.
retiring partners in the form of ‘golden handshakes’ and interest were generally considered to be quite properly taken into account in arriving at a profit figure.\footnote{Evidence of Mr Dickens and Mr Cane, \textit{First Report from the Select Committee on the Income and Property Tax}, above n 26, 152-3.}

However the taxation of ‘real’ economic gains according to generally accepted accounting standards was apparently contradicted by the specific deduction provisions found in Schedule D. Firstly, the Act expressly excluded deductions with respect to capital costs. No deduction, for example, was allowable with respect to the costs of repairs to premises occupied for the purposes of the taxpayer’s business, or for amounts ‘employed or intended to be employed as capital’.\footnote{\textit{Income Tax Act 1853}, s 100, Schedule D, Case 1 Rule 3.} When the position of a taxpayer holding a wasting capital asset is considered, this legislative exclusion clearly ran contrary to any principle of ability to pay understood in terms of taxation upon ‘real’ gains. Secondly, although it was generally accepted for accounting purposes that interest was a legitimate deduction from revenue in arriving at a profit/loss figure, the income tax legislation did not allow any deduction with respect to interest incurred in the course of the taxpayer’s business.\footnote{\textit{Income Tax Act 1853} s 100, Schedule D, Rule 4 which excluded ‘annual interest, while Schedule D Rule 3 was subsequently interpreted to exclude interest expenses with respect to amounts borrowed which were to be employed as capital: \textit{The Anglo-Continental Guano Works v Bell} (1894) 3 TC 239.} This measure meant that interest income was taxed twice, albeit in the hands of different taxpayers.\footnote{According to the explanatory pamphlet accompanying the income tax legislation of 1803, above n 26, it had originally been considered improper to compel disclosure of the identity of creditors, and under the original Act of 1799 interest had been deductible. Taxpayers had availed themselves of the opportunity to evade tax by overstating the quantum of the debt in order to inflate their deductions, knowing that the creditor would not have to include the non-existent interest income in their own income. In 1803 Addington introduced a system where income tax was deducted at the source of the income by the payor, who remitted the tax to the tax office. After the introduction of this withholding system, tax upon interest was withheld by the debtor who therefore no longer had an incentive to overstate the quantum of the debt. The second innovation introduced by the 1803 legislation to combat tax evasion was to exclude interest from the list of allowable deductions. Although the 1803 pamphlet suggests that the exclusion of deductibility protected the revenue, this result was achieved at the cost of tax equity if the income concept was understood in some sense of economic gain. In a flat rate income tax system where there were no tax rebates to creditors not liable to income tax and whose interest income had been taxed at source, the new treatment of interest income introduced in 1803 in a 96}
indication that the Parliament had not intended to tax net economic gains may be seen in the rules regarding deductions under Schedule D, Cases 1 and 2. The general deduction provision, comprising the first of the rules applicable to Cases 1 and 2, was expressed in the following way:

In estimating the balance of the profits or gains ... to be charged according to either of the first or second cases, no sum shall be set against or deducted from, or allowed to be set against or deducted from such profits or gains, for any disbursements or expenses whatever, not being money wholly and exclusively laid out or expended for the purposes of such trade.\[^{61}\]

This provision was problematic in that it suggested that the 'profits or gains’ were a gross figure from which the allowable deductions were taken away in arriving at the 'balance of profits or gains’. The statutory reference to 'gains’ could therefore not be a net figure representing the 'real’ economic position of the taxpayer. For the reference to ‘gains’ in Schedule D to be construed as an imposition of income tax according to the taxpayer’s ‘real’ ability to pay, the courts would have had to ignore the statutory exclusion of deductions not expressly allowed for under the Act,\[^{62}\] and also the express deduction provisions such as those contained in Schedule D. The final indication that the legislation was not intended to apply to some broad notion of gain was that losses under one Schedule were not available to be set off against profits under another Schedule, despite the recommendation in favour of this amendment at the committee stage in the House of Commons.\[^{63}\]

The income tax legislation therefore included provisions which might have suggested that ‘income’ embraced some notion of real gains measured according

\[^{61}\] Income Tax Act 1842, s 100, Schedule D, Rules applying to Cases 1 and 2, Rule 1.
\[^{62}\] Income Tax Act 1842, s 159.
to accounting standards, but also incorporated provisions which appeared to exclude this conclusion. This legislative ambivalence mirrored the ambivalence of the contemporary literature upon this matter. On the one hand, there was a considerable body of opinion which suggested that the income tax ought be extended to impose a tax upon ‘property’ in the sense of net wealth. On the other hand, there was a substantial body of opinion which conceded that an ideal income tax might apply to ‘property’, but accepted that the limitations of the tax administration meant that this was an impossible ideal. Although the latter view generally prevailed, the point for present purposes is that at the time it was not clear whether the legislation was intended to apply to a wide range of economic gains, and that it was only the administrative difficulties that precluded this broad income tax from being enforced, or whether the meaning of the income tax legislation excluded such a broad concept of income from the outset.

63 Sabine, above n 11, 62; this apparent anomaly was finally overridden by (1890) 53 & 54 Vict, c 8 s 23.
64 See the material cited at n 56 above.
65 At that time there were no legal powers to compel taxpayers to provide information regarding income and many business taxpayers simply did not keep adequate records of their receipts and expenditure, particularly farmers (evidence presented by Mr J Nicholson, Surveyor of Taxes in Manchester, First Report from the Select Committee on the Income and Property Tax, above n 26, 351). The limits of the tax administration of the early Victorian period are indicated by the Tax Office Solicitor’s observation in 1852 that there were relatively few prosecutions for evasion of the income tax because of the difficulty of gathering sufficient evidence to establish that a fraud had been perpetrated; First Report from the Select Committee on the Income and Property Tax, 50 (evidence presented by Mr J Timms, Solicitor of Inland Revenue).
66 Even in more recent times the uncertainty as to which is the appropriate ideal has continued to plague the tax reform literature. The work of the ‘founding father’ of modern income tax policy reflects this uncertainty; see: Henry Simons, Personal Income Taxation (1938), ch 2; Boris Bittker, ‘A “Comprehensive Tax Base” as a Goal of Income Tax Reform’ (1967) 80 Harvard Law Review 925; Mark Burton, ‘Economic Income and the Search for a Fair and Simple Income Tax’ Australasian Tax Teachers Conference, Brisbane, 19 January 1996.
(d) The Formulation of the Income Concept by Reference to a Combination of the Preceding Three Concepts of Income

Although it may have been accepted that the income tax legislation did not uniformly assess all 'real' gains, the general provisions of the Act might have been understood to assess revenue flows while Case VI of Schedule D assessed gains in wealth over and above those revenue flows. However, it has already been noted that some of the specific rules under the other Cases of Schedule D were apparently founded upon a concept of income which differed from 'real' gains. This attempt to reconcile Case VI with the other provisions of the legislation would therefore have meant that the reference to 'profits and gains' in the other Cases of Schedule D had a different meaning to 'profits and gains' under Case VI of Schedule D. Whilst it is possible for a term to assume different meanings in the same Act of Parliament, there is a general presumption that this is not the case.67 Indeed, the indeterminate nature of the scope of Case VI of Schedule D was implicitly acknowledged in the contemporary official literature published as a guide to taxpayers, it being left to the taxpayer to exercise his or her own judgement on this matter and trust that the Commissioners of Appeal would agree.68

D The survival of the fractured income tax

Although the title of the legislation and the contemporary official literature suggested that there was one income concept embodied in the legislation,69 the

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67 In more recent times, this proposition was recognised by Lee J in Wilson v Commissioner of Stamp Duties (1986) 6 NSWLR 410 at 418-19.
68 Anon, above n 26, 32.
69 'The income of Persons presents itself as the most obvious subject of equal taxation, without permanently affecting property from which the Income is derived. Income is continually renewing itself. The amount is ascertainable by positive evidence, and cannot be a subject of difficult enquiry, and seems peculiarly adapted to be the subject of a tax to provide for annual supplies.' Anon, Observations Upon the Act for Taxing Income In Which the Principles and Provisions of the Act are Fully Considered With a View to Facilitate its Execution, Both with Respect to Persons Chargeable, and the Officers Chosen to Carry it Into Effect (1799) 3-4. 'The principle of the Income Tax, as the word "income" seems to imply, is an impost on that
preceding discussion suggests that there was more than one concept of income underlying the legislation. The statutory references to ‘profits or gains’ could have been understood to adopt some notion of accounting profits recognised by business people in ascertaining business profits, some broader notion of real economic gains, a technical meaning adopted for the purposes of the rating legislation or some combination of the above three. Yet no one concept of income could be adopted throughout the act without altering what seemed to be the intended scope of some of the provisions under the various schedules.

Despite this uncertainty regarding the scope of the income tax base and the substantive criticisms of the legislation after 1842, the legislation remained largely in its original form. There were three reasons for this legislative inertia.
Firstly, for 30 years after the revival of the income tax in 1842 it was consistently maintained that the income tax was only a short term expedient rather than a permanent tax. After all, the tax was introduced for just three years in 1842 and for varying terms for the next 30 years. On the basis that the tax was only a temporary measure, there was perhaps some understandable reluctance to devote considerable resources to the revision of what was only a temporary fiscal measure.

Secondly, the absence of any consensus upon the ideal concept of income undermined any calls for a wholesale revision of the tax. As a result, the two Select Committees convened by the House of Commons in 1852 and 1861 were unable to agree upon any recommendations for reform:

Your Committee, however, after full consideration, have arrived at the conclusion that the plan proposed by their Chairman does not afford a basis for a practicable and equitable re-adjustment of the Income Tax; and they feel so strongly the dangers and ill consequences to be apprehended from an attempt to unsettle the present basis of the tax, without a clear perception of the mode in which it is to be reconstructed, that they are not prepared to offer to Your Honourable House any suggestions for its amendment. This tax having now been made the subject of investigation before two Committees and no proposal for its amendment having been found satisfactory, Your Committee are brought to the conclusion that the objections which are urged against it, are objections to its nature and essence rather than to the particular shape which has been given to it.

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72 In 1845 8 & 9 Vict c 4 (Eng) (An Act to continue for three years the duties on profits ...) reimposed the tax for an additional 3 years; in 1848 11 & 12 Vict c 8 (Eng) (An Act to continue for three years the duties on profits ...) reimposed the tax for an additional 3 years; in 1851 the income tax was reimposed for just one year by 14 Vict c 2 (Eng) (An Act to continue for three years the duties on profits ...). In 1852 the tax was imposed for just one more year by 14 & 15 Vict c 12 (Eng) (An Act to continue for three years the duties on profits ...); in 1853 it was imposed for a further seven years by the Income Tax Act 1853 (UK) 16 & 17 Vict c 34.

73 Report from the Select Committee on the Income and Property Tax, above n 52, iii-iv. To similar effect see: United Kingdom, Twenty-Eighth Report of the Commissioners of Her Majesty's Inland Revenue (1884-1885) 84-5.
Thirdly, for the 100 years after its reintroduction, the income tax was not a mass tax with relatively high rates of taxation, by contrast to the modern income tax. Rather, the rate of income tax remained relatively low and the exemption threshold was maintained at such a level as to exclude the bulk of wage and salary earners. As with the window tax in the seventeenth century, the income tax was a relatively small part of the total tax structure throughout the nineteenth century. It is therefore understandable that there were only piecemeal efforts to resolve the perceived inconsistencies of the income tax legislation over this period.

E Early Administrative Interpretations of the Income Tax and the Creation of the Statutory Right of Appeal to the Courts

Under the first income tax of the Napoleonic wars, the prevailing pro-revenue construction of tax legislation had been adopted when an income tax matter had reached the courts. As such, any difficulties with competing interpretations of the legislation were resolved in favour of the revenue. From 1842 until 1875 there was no statutory right of appeal in income tax matters, and so the courts were largely sheltered from the need to interpret the income tax. However, this does not mean that the competing interpretations of the tax were irrelevant.

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74 In the first decades of the income tax the tax-free threshold was £150. According to R Dudley Baxter only a small percentage of the population received income in excess of this threshold see: Eric Hobsbawm, *Industry and Empire* (1969) 154.
75 Sabine, above n 11, passim.
76 Sabine, above n 11, 245-6.
77 *Attorney General v Coote* (1817) 4 Price 183; 146 ER 433.
78 The reason for this has variously been suggested as the fact that the income tax was initially perceived as a war measure; V Grout and BEV Sabine, ‘The First Hundred Years of Tax Cases’ (Pt 1) (1976) *British Tax Review* 75; V Grout and BEV Sabine, ‘The First Hundred Years of Tax Cases’ (Pt 2) (1976) *British Tax Review* 239; or that the income tax would not have passed through Parliament if it had been thought that an appeal to the courts would lead to compulsory disclosure of the taxpayer’s financial affairs H Monroe, *Intolerable Inquisition?* (1981) 44-6. Upon reintroducing the income tax in 1842, Sir Robert Peel suggested that there had been a tradition of local administration founded upon the principle that a subject ought not be required to disclose his or her affairs to anyone other than their immediate neighbours rather than the central administration; House of Commons, *Hansard*, 18 March 1842, 911 (Sir Robert Peel, Prime Minister).
to the administration of the income tax until 1875. Prior to that time, Pitt’s adaptation of the local administration of the inhabited house tax had left the administration of the income tax in the hands of the local administration, supervised by Commissioners of Appeal and the Tax Inspectors of the Tax Office. The fact that at least some branches of this local administration and the local Commissioners of Appeal adopted a diverse array of interpretations of the income tax is apparent from the 1852 Select Committee report. Thus whilst it seems to have been generally accepted that Schedules A and C taxed gross receipts regardless of any diminution of the capital assets from which such flows were derived, Schedule D was applied with a considerable degree of latitude on the part of the local administration. Although there was no express allowance for depreciation in the legislation, for example, in at least some districts such an allowance was granted. On the other hand, there is evidence that some Commissioners adopted the Board’s opinion of how an appeal ought be decided.

The period of 1842 to 1875 was therefore a period in which the confrontation of taxpayer and Tax Office regarding the competing conceptions of income for the purposes of the income tax was moderated by the discretion of the local administrators. At the time that the statutory right of appeal to the courts was

79 See, for example, the evidence presented by Mr Hyde to the 1852 Select Committee; First Report from the Select Committee on the Income and Property Tax, above n 26, 171.
80 The Surveyor of the City of London commented: ‘[w]e generally take, in the great manufacturing districts, the scale [of depreciation] allowed by the manufacturers themselves sitting as Commissioners.’(see: United Kingdom, above n 26, question 1285; while in Birmingham the Surveyor noted that he allowed the cost of repairs but not depreciation (ibid, questions 369-390).
81 Ibid, 298-9 (evidence of Mr George Offor).
82 Aside from the inequity arising from the inconsistent application of the income tax across England in this period, the breadth of discretion vested in the Commissioners and the way in which it was exercised in some cases also raised concerns as to the professionalism of the local administration. That the central Tax Office was frustrated by this discretion exercised at the local level is apparent from the evidence presented to the 1852 Select Committee. In his evidence presented to the Committee, one Surveyor of Taxes suggested that there was a considerable need for the Surveyor to have a right of appeal against the decision of the
granted, the courts were propelled into a whirlpool of competing interpretations of the income concept. At the same time, the mainstream account of tax interpretation suggests, legal formalism was approaching its zenith. According to the generally accepted account of tax interpretation, the legal formalism of the courts displaced the discretion of the local tax administration, and ushered in a new era where the liabilities of taxpayers were clearly determined according to 'the literal meaning' of the law. According to this account, the existence of competing interpretations of a statute did not mean that the income tax legislation was indeterminate, because it was the function of the courts to consider such competing interpretations and discover the one true meaning of the legislative words. The courts purportedly focused upon the semantic meaning of the statutory words in isolation from the context in which the legislation was applied, regardless of any perceived injustice which might arise from applying the literal meaning.

There is no doubt that there is a large number of judicial statements which lend a veneer of credibility to this account of tax interpretation in Victorian England. The decision of Lord Cairns in 1869 is often cited as authority for the proposition that a strict literalism was entrenched by the time that the statutory right of appeal to the courts was created:

If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might appear to be.  

As the nineteenth century drew to a close, it has been suggested, the courts adopted an even more strident declaration of the literalist method advocated in

Commissioners (or Special Commissioners as the case may be) in order to ensure that the Commissioners were acting impartially: ibid, 186.
earlier periods. This portrayal of the courts at the zenith of a literalistic formalism seems consistent with decisions such as *Bowers v Harding*:

But we are here to administer the law as we find it, and though Mr. Dicey has pointed out to us what are anomalies, which I am afraid must always exist in the incidence of taxation under any Act of Parliament which has to provide for a tax such as the Income Tax, still I cannot myself think that there is any real difficulty in applying the statute to the circumstances of this case. 85

It seems clear from statements such as that of Lord Cairns in *Partington* and that of Pollock B in *Bowers* that the courts had clearly rejected the consideration of pragmatic consequences acknowledged by the golden rule, at least in the context of tax decisions. Further, in a subsequent decision Lord Halsbury maintained that a literalist methodology was no different to a purposive reading of the statute:

I do not think it is competent to any court to proceed upon the assumption that the Legislature has made a mistake. Whatever the real facts may be, I think a court of law is bound to proceed upon the assumption that the Legislature is an ideal person that does not make mistakes. It must be assumed that it has intended what it has said, and I think any other view of the mode in which one must approach the interpretation of a statute would give authority for an interpretation of the language of an Act of Parliament which would be attended with the most serious consequences. 87

Over the course of the last decade of the nineteenth century Lord Halsbury, in particular, enunciated the rationale for this strict literalism by drawing upon various aspects of contemporary political philosophy. In his dissenting judgment in *The Commissioners for Special Purposes of the Income Tax v* 83

83 *Partington v Attorney-General* (1869) LR 4 HL 100 (Lord Cairns).
85 *Bowers v Harding* (1891) 3 TC 22, 25 (Pollock B).
86 *Grey v Pearson* (1857) 6 HLC 106; (1843-60) All ER 21, 36 (Lord Wensleydale).
87 (1891) 3 TC 53, 71.
Pemsel, his Lordship clearly endorsed the sanctity of individual property rights by stressing that the only purpose of tax legislation was ‘to raise money’, and that it was therefore for the legislature to ensure that a tax was clearly imposed. In the later case of Gresham Life Society v Bishop his Lordship acknowledged the Diceyan theorisation of the sovereignty of Parliament by suggesting that the rationale for a literal interpretation of legislation was that Parliament could readily change the legislative rulebook if some undesirable circumstances arose:

It cannot be said that the use of artificial meaning to be attached to ordinary language is either unknown or unusual in legislation; and if it was intended to make this a special subject of taxation, to be taxed whenever and wherever an equivalent amount was credited or booked or in any other way recognised as having come under the dominion of the owner in this country, nothing could have been easier than to enact it in plain terms.

There are therefore ample contemporary judicial statements which suggest that the courts uniformly accepted as a matter of principle that they ought adopt the strict construction of tax legislation according to the literal meaning of the statutory terms. However, regardless of whether literalism means that the courts apply the acontextual meaning of the words, the meaning of the words determined at the time the legislation is made or the meaning of the statutory words at the time they are interpreted by the courts, this portrayal of literalism in the context of the income tax of Victorian Britain is problematic. The preceding discussion suggests that there was no one generally accepted understanding of the terms ‘profits or gains’ in Victorian England. At the least, those terms seem to have been understood in various contexts in terms of gross flows, accretions

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88 Ibid.
89 Ibid 73. A literalist rhetoric was adopted by Halsbury with respect to all statutes; see, for example, Earl Grey v Att General [1900] AC 124; Fielden v Morley Corp [1900] AC 133; Smith v Lion Brewery [1911] AC 150 at 157. For a slightly earlier affirmation of ‘literalism’, see: Commissioner of Inland Revenue v Angus and Co (1889) 23 QB 579, 593.
90 (1902) 4 TC 464.
91 Ibid 473. See also: San Paulo Railway Company Limited v Carter (1895) 3 TC 407, 410; Andrews v Mayor (1892) 3 TC 236, 238 (Collins J).
to net wealth or profits for accounting purposes. This suggests that the courts of Victorian Britain could not have applied the ‘literal’ meaning that they expressly endorsed. If the judiciary was not adopting the interpretative approach that it said it was applying, what approach was it adopting?

**F Judicial Interpretations of the Income Tax Base**

1 Early Judicial Ambivalence

The early case law suggests that in the first years after the right of appeal to the courts was granted, the courts adopted widely differing interpretations of ‘profits and gains’ for the purpose of the income tax. In some early decisions the courts seemed to accept that the income tax was intended to assess the ability of a taxpayer to pay tax in a global sense, such that all accretions to the taxpayer’s wealth would be liable to income tax. For example, in *Attorney-General v Black* 92 Martin B commented that Schedules A, B, C and E:

[W]ould seem a sufficiently large net to include every description of property; but to prevent any doubt we have section 100 [incorporating Schedule D], which imposes a duty on every description of property or profit not contained in the foregoing schedules. In fact, the care displayed in embracing every possible source of profit is, I may say, carried to an almost ludicrous extent; it is practically impossible to escape the operation of the Act. 93

Although Martin B left the meaning of profit to be determined, the tenor of his observation and his reference to ‘every description of property’ indicates that he considered that the income tax caste a broad net across a wide range of gains which contemporary economists categorised as a property tax. 94 The references to the taxation of ‘property’ in the preceding extract were therefore most significant. The broad scope of Schedule D Case VI was also accepted in *Re*

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92 (1871) 1 TC 52.
93 Ibid 53; see also: *Attorney-General v Black* (1871) 1 TC 54, 54 (Lord Blackburn).
Strong, where a gift presented to a minister of religion by his congregation was considered to fall not only within the meaning of 'emolument' for the purposes of Schedule E, but also was considered to be a 'gain' under Schedule D.

However this judicial flirtation with a broad notion of income, which drew upon the economist's concept of a property tax, was never received into the mainstream interpretation of the income tax. In Knowles v McAdam the suggestion that income ought be understood in terms of 'economic gain' was expressly rejected by Cleasby J, who noted that a testamentary gift was not income to the beneficiary because such a receipt was a capital sum which did not fall within the 'annual profit' of the taxpayer. In other cases the deductibility of certain expenses was rejected. The reasoning underlying this conclusion was that to allow such deductions would be inconsistent with the express provision of the legislation, notwithstanding that such deductions would have been quite consistent with a concept of income understood in terms of economic gain. This rejection of the economic concept of income was founded upon the view that the reference to 'profits' ought be understood in its technical sense. This meant that 'income' connoted a flow of revenue from a capital source or from particular earning activities such as employment, and did not include accretions to capital or other accretions to wealth. Notwithstanding the occasional recognition of the equivalence of 'economic gains' or 'property' with income, the economic discourse was marginalised by the judiciary of Victorian England.

94 For discussion of the property tax see: United Kingdom, above n 52, passim.
95 (1878) 1 TC 207.
96 (1877) 1 TC 161.
97 Ibid 168.
98 See, for example, Addie & Sons v Commissioners for General Purposes (1875) 1 TC 1; Forder v Handyside and Co Ltd (1876) 1 TC 63; Caledonian Railway Company v Banks (1880) 1 TC 487; Watney v Musgrave (1880) 1 TC 272, 276; for a later case to similar effect see: Brickwood v Reynolds (1897) 3 TC 600.
2 Accounting Practice and the Calculation of Profit

While a gains concept of income was rarely referred to, elements of this concept of gain may be seen in an alternative concept of income which was considered more seriously by the courts. It has already been noted that the emergent accounting profession was developing standards for the measurement of profits for commercial purposes, and so it was understandable that the accounting measurement of profits was considered by some to offer a valid measurement of profits for income tax purposes. Those advocating the applicability of accounting concepts of income and profits therefore maintained that the 'ordinary' meaning of those terms ought be considered to be the meaning adopted for accounting purposes. This argument was raised in relation to two issues in the Victorian income tax cases. The first concerned the extent to which various business expenses could be deducted from the gross income figure in arriving at a profit amount upon which income tax would be assessed. The second concerned the treatment of extraordinary receipts outside the ordinary course of the taxpayer's business. For the purposes of this chapter it will be sufficient to consider the judicial response to the first issue.

With respect to the first issue in Imperial Fire Insurance Company v Wilson the insurer had prepared its accounts by taking premiums received and deducting administrative expenses and the cost of claims made in order to arrive at a profit/loss result. The insurer had historically submitted the profit/loss figure calculated in this way for the purposes of the income tax. However, for the purposes of the income tax in the most recent accounting period, the insurer had, for the first time, taken account of unearned premiums by matching the

100 Note that some, such as Krever, above n 56, overlook the first category of cases in suggesting that the recognition of a more restricted concept of income invariably worked in favour of the taxpayer.
101 (1875) 1 TC 71.
period of the risk covered for each premium to the relevant accounting period. At the same time, the taxpayer prepared its accounting profit/loss statement according to its past practice, whereby there was no matching of premiums to the accounting period. The court considered that the Commissioner was justified in adopting the method of accounting which the taxpayer had used in drawing up its profit/loss statement, rather than the method used in preparing its tax return. This conclusion meant that the taxpayer was assessed upon all premiums received notwithstanding that a part of the premiums was in a sense 'unearned income' as it related in part to the relevant income year, and in part to the subsequent year. Further, although the matter was not specifically raised on appeal, the court accepted that the taxpayer could not anticipate unnotified insurance claims in reaching its profit/loss result for income tax purposes, notwithstanding that the court accepted that such anticipated losses could be actuarially quantified.\textsuperscript{102} For present purposes, the case is significant in that the court acknowledged that the taxpayer's accounting practice was crucial to the outcome of the case. Indeed, Amphlett B noted that, if the taxpayer had changed its accounting method, it may have been possible for the taxpayer to compel the Commissioners to accept the amended method of accounting.\textsuperscript{103} The decision in \textit{Imperial Fire Insurance Company} therefore suggested that it was legitimate to take account of commercial or accounting practice in interpreting the tax legislation, a view which was subsequently endorsed in a number of cases.\textsuperscript{104}

\textsuperscript{102} This principle was thereafter accepted in the absence of statistical evidence by which the insurance contracts written by a particular taxpayer were analysed such that it was possible to identify the extent to which the insured remained exposed to unexpired risks at the end of the relevant accounting period. See, for example, \textit{The General Accident Fire and Life Assurance Corporation v M'Gowan} (1907) 5 TC 308.

\textsuperscript{103} Ibid 76; see also the decision of Huddleston B, 76.

\textsuperscript{104} See, for example, \textit{Highland Railway Co v Balderston} (1889) 2 TC 485 where the Scottish Court of Exchequer held that the taxpayer's bookkeeping practice was not determinative of the meaning to be attributed to statutory words, although it was implicit in the judgment that the business treatment of an expense will be a critical factor in the absence of any statutory rule suggesting a contrary meaning.
However, in some cases there seemed to be a conflict between the accounting measurement of the profits of an enterprise and the measurement of profits required under the income tax legislation. As has already been noted, the uncertainty regarding the proper application of the income tax legislation was exacerbated by the fact that the income tax legislation incorporated several inconsistent concepts of income under the various Schedules and, indeed, even within the particular Schedules. The crucial issue confronting the courts was therefore the extent to which accounting practice ought influence the meaning of profits under the income tax. This question arose once again in Knowles v McAdam, \(^{105}\) where the taxpayer had been assessed with respect to the profits of a coal mine, but sought to claim an allowance in recognition of the diminishing value of the resource as it was depleted. The decisions in the Court of Exchequer focused upon the meaning of 'profits' in 'ordinary' parlance. In a decision which implicitly acknowledged generally accepted accounting practice, all of the members of the court considered that the capital value of the mine was legitimately amortised over its lifespan in ascertaining the profits of the mining enterprise for the purposes of the income tax.

However there was by no means judicial unanimity upon the extent to which the Act defined the income tax base in accordance with accepted accounting practice. Indeed, the first case in the first volume of the Tax Cases\(^{106}\) reflects a denial of accounting practice in determining taxable profits. In that case the taxpayer sought to deduct an amount in recognition of the depreciating value of mine shafts it had constructed. However, the deduction was expressly rejected on the basis that such expenditure fell within the specific exclusion of 'any sum employed or intended to be employed as capital in such trade, manufacture, adventure or concern'. The Court accepted the accounting definition of 'capital'. Noting that the amount expended for the sinking of the mine shaft would be

\(^{105}\) (1877) 1 TC 161.
\(^{106}\) Addie & Sons v Commissioners for General Purposes (1875) 1 TC 1.
treated as capital in the taxpayer's books, the court concluded that it should be
treated as capital for the purposes of the income tax.\textsuperscript{107} However, in a
significant departure from accounting practice and despite its partial
acknowledgment of accounting practice with respect to the definition of capital,
the Court held that the 'special rules of the Income Tax Act'\textsuperscript{108} indicated that no
amortisation could be allowed in respect of the capital investment in the mine
shafts.

3 \textit{The Search for Coherence}

Within the first five years in which there had been a statutory right of appeal to
the courts the judiciary had, in different cases, adopted all of the competing
interpretations of the income concept which had been canvassed in the
contemporary literature. Although the economic concept of income was
allowed to slip into obscurity, the disorder of the law in this field was apparent
in the conflicting decisions of \textit{Addie} and \textit{Knowles}. In \textit{Addie} the court had
acknowledged the discourse of the business community by adopting the
accounting concept of 'profits' and downplaying those parts of the legislation
which suggested that no amortisation expense was allowable under the Act. In
\textit{Knowles}, on the other hand, the court considered that it was bound to give
greater emphasis to the technical meaning of 'profits' in accordance with the
rules governing the measurement of profits for income tax purposes. Clearly,
the two cases illustrate the fundamental conflict of competing standpoints
within Victorian England regarding the meaning of 'profit', and hence the
absence of one 'literal' meaning of the term. This conflict was made all the
more problematic by the fact that, no matter which approach was adopted, the
result would seem to contradict at least one conception of justice. On the one
hand, if the courts adopted the accounting concept of profits, the express

\textsuperscript{107} Ibid 3.
\textsuperscript{108} Ibid 3.
exclusion of any deduction not otherwise allowed under the Act was rendered otiose. This seemed to contradict the ideal of formal justice which the courts regularly espoused. On the other hand, if the technical meaning of ‘profits’ in terms of gross flows was adopted, this seemed to breach notions of substantive equity. As noted previously, a subject of considerable debate had been the fact that Schedule A brought actual or imputed gross profits into account while Schedule D was taken to bring gross profits net of some expenses into account. In 1868 the assessment of mines, railways, ironworks, gasworks and similar ventures had been transferred from Schedule A to Schedule D, apparently with the intention that such ventures ought be able to avail themselves of the same tax administration mechanisms as other business ventures. However, many business ventures remained within the domain of Schedules A and B, and so the perceived inequity of differential treatment of different categories of business profits remained. The early interpretation of the income tax is therefore marked by a conflict between competing conceptions of income, and also by the competition between rival notions of justice. These fundamental conflicts had to be resolved if the judicial pretensions to discovery of determinate legal meaning were to prevail.

These conflicts arose for examination in the House of Lords in *Colness Iron Co v Black*. In *Colness* the taxpayer carried on a mining business and was assessed for the annual value of the mines it owned (determined according to the profits therefrom). The issue was whether the taxpayer was entitled to claim a deduction for the amortised cost of sinking its mines. If the deduction for mine shaft expenses had been allowed in *Colness*, the calculation of the taxpayer’s profit for taxation purposes would have been the same as the calculation of the taxpayer’s accounting profit. The case therefore called for a


110 (1881) 1 TC 311.
reconsideration of the decision in *Knowles*. In rejecting that decision, the House of Lords ignored arguments founded upon the 'ordinary' meaning of 'profits', and instead maintained that the legislative intent evidenced by the words of the legislation was determinative:

But the object is to grant a revenue at all events, even though a possible nearer approximation to equality may be sacrificed in order more easily and certainly to raise that revenue; and I think the only safe rule is to look at the words of the enactments, and see what is the intention expressed by those words.\textsuperscript{111}

The basis of the House of Lords decision was that the legislature had intended to adopt the technical meaning of 'profits' as used in the rating acts. The rating acts taxed the annual value of property according to the annual income flowing from the property,\textsuperscript{112} irrespective of the wasting character of some forms of property (such as mineral deposits):

But the argument that no income tax should be imposed on what is perhaps not quite accurately called rent reserved on a mineral lease, because it is a payment by instalments of the price of minerals forming part of the land (any more than on the price paid down in one sum for the out and out purchase of the minerals forming part of the land), is, I think, untenable. Even if it had not been as decided in the *King v Attwood* ... the constant course from the statute of Elizabeth downwards to construe an annual tax imposed on coal mines, quarries, and the like, as being imposed on that which is produced from them.\textsuperscript{113}

In reaching this conclusion Lord Blackburn considered the overall scheme of the Act. His Lordship noted that, whilst the specific Schedules generally taxed 'profits', the argument that that term was intended in its 'ordinary' commercial sense was precluded by the fact that the allowance of specific deductions from 'profits' implied that 'profits' meant gross receipts. Further, his Lordship noted

\textsuperscript{111} Ibid 317.
\textsuperscript{112} Ibid 317 (Lord Blackburn); the adoption of the method of taxation of the rating acts was implicit in the decision of Lord Penzance.
that the statutory prohibition of any deductions not expressly allowed under the Act precluded the taxpayer's claim.\textsuperscript{114} Thus, according to Lord Blackburn, 'profits' was to be taken in its technical sense. His Lordship concluded that only expenses incurred in deriving the income flow and those expenses expressly allowed as deductions under the Income Tax Act 1852 were to be taken into account in arriving at a profit figure.\textsuperscript{115}

Given Lord Blackburn's preparedness to adopt a 'flow' concept of profits and also his acknowledgement that only those expenses expressly allowed as deductions from profits under the Act should be taken into account in computing taxable income, his allowance of 'working expenses' as legitimate deductions is problematic. If 'profits' meant gross receipts from which certain statutorily enumerated expenses could be deducted in arriving at taxable income, it is unclear how 'working expenses' could legitimately be taken into account other than by recourse to the express deduction provisions. Alternatively, if 'profits' meant gross receipts less certain working expenses and statutory deductions, it is unclear why the taxpayer's claim for amortisation of a wasting asset was considered to fall outside the category of 'working expenses'. Neither of the more detailed decisions of Lord Penzance and Lord Blackburn expressly set out the basis for taking working expenses into account, or any criteria for identifying the working expenses of any income earning activity. More specifically, it is not apparent from any of the judgments why the cost of sinking a mine pit was considered to fall outside the category of 'working expenses'. Nevertheless, after Coltness it was accepted that no deduction was

\textsuperscript{113} Ibid 321 (Lord Blackburn); 314 (Lord Penzance).
\textsuperscript{114} See also: Gillatt and Watts v Colquhoun (1884) 2 TC 76, 83-4 (Smith J).
\textsuperscript{115} Ibid 323 (Lord Blackburn); 314 (Lord Penzance).
available under Schedule D for the depreciation or amortisation of capital assets, unless the Act was considered to specifically allow such a deduction.116

The ramifications of the Coltness decision extended beyond the interpretation of Schedule D. All of the categories of income listed in the Schedules except Schedule D were generally to be ascertained according to the profits of the taxpayer from a particular source. Further, it was subsequently implied that ‘gains’ added little to ‘profits’ for the purposes of Schedule D.117 The decision in Coltness therefore suggested that, in the absence of any specific provision to the contrary, the profits of the taxpayer for the purposes of all of the Schedules to the Act were the flows to the taxpayer, less the working expenses, regardless of whether the taxpayer derived an accounting profit. The effect of the decision in Coltness was that ‘profits’ had the same ‘technical legal meaning’ under both Schedules A and D, an approach affirmed in subsequent cases.118

While the House of Lords had purported to apply the literal meaning of the Income Tax Act 1853, the decision in Coltness indicated that the House of Lords was prepared to construct an underlying concept of income from the ad hoc

116 The decision in Coltness was followed in Gillat v Colquhoun (1884) 2 TC 76 (amortisation of leasehold interest); The City of London Contract Corporation v Styles (1887) 2 TC 239 (purchase price of unexecuted contracts); The Alianza Co Ltd v Bell (1904) 5 TC 60; 5 TC 172 (deduction with respect to depletion of mineral resource); Mersey Docks and Harbour Board v Lucas (1883) 2 TC 25 (application of revenue to payment of interest and also to a sinking fund for extinguishment of debt incurred in construction wharves and docks). An allowance for depreciation under Schedule D was inserted in 1878 by the Customs and Inland Revenue Act 1878 (Eng), s 12, although no capital writeoff for capital items was included in the Act. More generally, it was recognised that the accounting treatment of a particular expense was not determinative of the treatment of the particular expense for the purposes of the income tax; see, for example, Arizona Copper Co v Smiles (1891) 3 TC 149, 153.

117 Gresham Life Assurance Society v Styles (1892) 3 TC 185, 188-9.

118 'We constantly in law talk of profits of land. The old conveyances used to talk of the rents, issues, and profits of land, but those profits are what you get out of the land after deducting the expenses of getting them. The profits of a farm in that sense are not quite the same as the profits of the farmer, but may be fairly described as the net produce of the land. It is plain that that is the meaning to be attributed to the word in the 2nd and 3rd rules in Schedule A.' Mersey Docks and Harbour Board v Lucas (1881) 1 TC 386, 461-2 (Lindley MR); see also: Erichsen v Last (1881) 4 TC 422, 426, 428; Mersey Docks and Harbour Board v Lucas (1883) 2 TC 25 (House of Lords); Morant v Wheal Grenville Mining Co (1894) 3 TC 298. Although there were some dissentients. See, for example, Duke of Norfolk v Lamarque (1890) 2 TC 579, 582 (Pollock B).
collection of taxing provisions comprising the income tax legislation. Starting from the presupposition that substantive justice mandated that businesses ought to be treated in a similar way under both Schedules A and D, the House of Lords had confronted the quandary of determining which part of the *Income Tax Act 1853* it should ignore. In *Knowles* the Court of Appeal had been swayed by considerations of substantive justice, and had attempted to create some level of horizontal equity between Schedules A and D. This had been achieved by a relaxation of a formalist rhetoric. The Court of Appeal ignored the statutory restriction of deductions to those which were expressly allowed for in the legislation. In *Coltness*, the House of Lords moderated the apparent conflict between the competing imperatives of substantive and formal justice. The House of Lords adopted a compromise in which the reference to 'profits' was understood to mean gross revenue less some 'working expenses' which were not coextensive with expenses allowed for accounting purposes. This meant that a wider range of deductions was allowable under Schedule A than had previously been available. This interpretation of 'profits' also affected the interpretation of the general deduction rule of Schedule D. By giving 'profits' the same meaning under both Schedules A and D, the House of Lords had rendered the general deduction provision of Schedule D\(^{119}\) otiose. This general deduction provision operated only *after* the profits had been ascertained\(^{120}\) and therefore only after the 'working expenses' allowed for in the calculation of profits had been taken into account. As the 'working expenses' had to have a demonstrated nexus to the derivation of business receipts to be allowable

\(^{119}\) *Income Tax Act 1853* s 100, Schedule D, Rules applying to Cases 1 and 2, Rule 1. For the text of the rule see the extract accompanying n 61 above.

\(^{120}\) 'In estimating the balance of the profits of gains ...no sum shall be set against or deducted from...such profits or gains...', *Income Tax Act 1842*, s 100, Schedule D, Rules applying to Cases 1 and 2, Rule 1.
deductions under this provision, the nexus requirement expressed in Rule 1\(^{121}\) was redundant.

The interpretation of ‘profits’ adopted in *Coltness* therefore neatly skirted the express exclusion of deductions ‘from profits’\(^{122}\) not allowed for under Schedule A of the Act. This approach therefore ameliorated the horizontal inequity arising from the disparate legislative treatment of expenses apparent in Schedules A and D. *Coltness* therefore represented more than ‘giving effect to the words of the legislation’, and is perhaps more properly to be characterised as an attempt to reconcile the apparent inconsistencies within the income tax legislation in arriving at what was considered to be a just result.

4 The Coltness Compromise Begets Further Judicial Pragmatism

Although the allowance of working expenses in the *Coltness* decision might be considered a nice compromise between the ‘profits equals gross flows’ approach and the ‘profits equals accounting profits’ approach, the obscurity of the ‘working expenses’ category proved to be the Achilles heel of the decision. Subsequent case law therefore rehearsed the conflict between ‘profits equals gross flows’ and ‘profits equals accounting profits’.

Thus in *Last v London Assurance Corporation*\(^{123}\) the taxpayer was an insurance company which offered two categories of insurance policy. Firstly, there was the non-participating policy whereby the insured obtained insurance against the risk insured and no more. Secondly, under a participating policy, the insured obtained insurance against the risk insured but, in consideration for a higher

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\(^{121}\) Ibid.
\(^{122}\) Section 159 of the *Income Tax Act 1853* provided:
‘In the computation of duty to be made under this Act in any of the cases before mentioned...it shall not be lawful to make any other deductions therefrom than such as are expressly enumerated in this Act, nor to any deduction on account of any annual interest, annuity, or other annual payment to be paid to any person out of any profits or gains chargeable by this Act.’

\(^{123}\) (1884) 2 TC 100.
premium, also obtained the right to a share of the taxpayer's profits derived from the participating series of policies. 124 On behalf of the taxpayer, it was argued that this right to profit participation was no more than a conditional promise to return a portion of the premiums paid with respect to the participating policies. Viewed in this light, the 'distribution of profits' was merely another cost to the taxpayer's business and ought to have been deducted as a 'working expense' in arriving at the profit of the business, in accordance with the decisions of Coltness and Mersey Dock and Harbour Board v Lucas. 125 A majority in the Court of Appeal adopted this business understanding of profits. A key proposition of the majority judgment was that the profits of the taxpayer could only mean the sum of money ultimately available for distribution to the corporators, as it was not open to the taxpayer to bargain away some of its profits to persons other than the taxpayer's corporators.

Overruling the Court of Appeal decision, all of the Lords deciding the case adopted the 'gross receipts less working expenses' definition of income in accordance with Mersey Docks and Coltness. A majority of the House of Lords comprising Lords Blackburn and Fitzgerald held that it was possible for the taxpayer to distribute profits to non-shareholders such as the participating policyholders. On the basis that the distribution to participating policyholders was not a working expense, the majority held that it was a distribution out of profits which was subject to income tax in the hands of the taxpayer. Notwithstanding their common ground upon the exclusion of distributions to participating policyholders from the category of allowable working expenses, it is apparent that the two Lords in the majority did not share a common understanding of the income concept. Although at times Lord Fitzgerald

124 The taxpayer's prospectus provided that '[t]wo thirds of the gross profits of the participating series of policies are allotted every five years to the assured, every policy in force at the date of the valuation being entitled to participate. The assured have the option of receiving their share of the profits in cash, or of appropriating it in increase of the sum assured, or in reduction of the future annual premiums'; ibid 128.
expressly referred to the *Mersey Docks* formulation of the income concept, he also appeared to accept a much broader concept of profits equating to gross flows:

The conclusion that I have reached on the case as it comes before us, and not on any suppositious case, is that the premiums paid to the Company in respect of the participating policies form part of the annual profits of the Company just as much as any other portion of their revenue.  

If read broadly, this would suggest that *any* payment out of the taxpayer’s premium income would be a distribution of profits, perhaps upon the footing that there were no ‘working expenses’ associated with the generation of premium income. By contrast, Lord Blackburn seemed to accept that there could be some working expenses incurred by the taxpayer in generating its premium income. Thus Lord Blackburn specifically accepted that a refund of premiums to policyholders, which was not conditional upon the taxpayer having a ‘profit’ in the relevant year, would not be a distribution out of profits. Lord Blackburn’s observation is inconsistent with the definition of profits as receipts less working expenses incurred in generating those receipts, particularly given that Lord Fitzgerald had considered that all premium income would be profits. In his dissenting judgment, Lord Bramwell accepted the view of the Court of Appeal in characterising the distributions to the participating policyholders as a ‘working expense’ arising out of the generation of the premium income.

Although *Colness* had rejected the general adoption of accounting practice for the purposes of measuring the taxpayer’s profit under the income tax, the recognition of the category of working expenses had appeared to leave the way open for taxpayers to accommodate many of the accounting rules regarding expenses within the ‘working expense’ category. The decision in *London Assurance* represented a rebuff to this accommodation of accounting practice.

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125 (1883) 2 TC 25.
within the 'working expenses' category, emphasising that 'profits' were closer to gross receipts than to any concept of real profits recognised for business purposes.

Notwithstanding the rebuff in *London Assurance*, advocates of the accounting concept of profits continued to test the scope of the 'working expenses' category. It must be remembered that the more restricted understanding of the profit concept had only been adopted by bare majorities in both the Court of Appeal and the House of Lords, and the dissentients in those courts had clearly embraced the rhetoric of business practice in interpreting the income tax. It is therefore understandable that, in *Mersey Loan and Discount Company v Wootton*,127 the taxpayer felt emboldened enough to once again test the relevance of accounting concepts to the measurement of income for the purposes of the income tax. The taxpayer carried on the business of banking, receiving moneys on loan at interest and lending those moneys at interest. The taxpayer argued that the interest paid to its customers was a working expense rather than a distribution of profits for the purposes of the Act.128 Given the suggestion of Lord Blackburn in *London Assurance* that many payments made out of gross receipts which were not conditional upon the taxpayer having 'profits' comprised working expenses, the taxpayer had a credible argument that the interest expense was a working expense associated with its financing business. Pollock B dismissed this argument:

> Then is it a charge ... in the nature of current expenses. You would say house rent, taxes, salaries of clerks and others, and matters of that kind have to come, of course, out of the gross profits before they can make any income at all. It is not a charge of that kind.129

126 *Last*, above n 118, 129 (Lord FitzGerald).
127 (1887) 2 TC 316.
128 It should also be noted that the Act precluded any deduction on account of interest, see: *Income Tax Act* 1842, s 100, Schedule D, Case 1, Rule 3.
129 Ibid 320.
It was therefore held that payments of interest by the taxpayer were payments out of profits.\textsuperscript{130}

The combined effect of the decisions in \textit{Colness, London Assurance} and \textit{Mersey Loan and Discount Co} seemed to constitute a comprehensive rejection of the view that accounting practice was relevant to the measurement of income for the purposes of the income tax.\textsuperscript{131} Nevertheless, the strength of the conviction that the income tax ought only apply to real gains as measured by accountants is indicated by the fact that taxpayers continued to test the scope of the ‘receipts less working expenses’ definition of income. This persistence on the part of business taxpayers was ultimately rewarded. In \textit{Styles v New York Life Insurance Co}\textsuperscript{132} the only members of a mutual insurance company were those who had obtained participating insurance policies with the company. At the end of each accounting period, any surplus over operating expenses arising from the insurance business of participating policyholders was effectively distributed to the participating policyholders. After \textit{London Assurance} it might have been thought that there was but a forlorn hope that such distributions would be an allowable deduction out of the taxpayer’s profits, as opposed to a distribution of the taxpayer’s profits. However, the taxpayer had doubtless studied the decision of \textit{London Assurance} closely, and in particular the suggestion by Lord Blackburn that a refund of premiums would not constitute a distribution of profits.

\textsuperscript{130} See also: \textit{Stevens v Bishop} (1888) 2 TC 249.
\textsuperscript{131} See also: \textit{Russell v Aberdeen Town and Country Bank} (1888) 2 TC 321; cf \textit{Alexandria Water Co Ltd v Musgrave} (1883) 1 TC 521 (Court of Appeal). In \textit{Duke of Norfolk v Lamarque} (1890) 2 TC 579 the taxpayer sought to claim the cost of collecting manorial dues as a deduction from the profits brought to account under Schedule A. Pollock B considered that there was a difference between the expenses allowed in calculating profits for the purposes of Schedule D as opposed to those allowed in arriving at the profits under Schedule A. The confusion concerning the application of the definition of profits to particular factual scenarios is reflected in his comment that you cannot say that the collection of the rent is money spent for the purposes of earning the rent - it is simply money spent for getting in that which belongs to the owner.’ (at 582). See also: \textit{Granite Supply Association Limited v Kitton} (1905) 5 TC 168.
\textsuperscript{132} (1889) 2 TC 460.
In a clear rejection of the strict application of Lord Fitzgerald's view, a majority of the House of Lords held that the surplus did not comprise profits. The basis of this conclusion was that the distributions to members by New York Life Insurance were no more than a return of subscriptions to the members of a mutual fund. This recognition of a mutuality principle signalled a shift away from the technical meaning of profits and towards a preparedness to accommodate business understandings of the term. Indeed, in joining the majority, Lord Herschell commented upon the shortcomings of the strict definition of 'profits', suggesting that the undesirable consequences of this definition could be judicially ameliorated for pragmatic reasons in particular contexts:

> These definitions were, I doubt not, correct in relation to the facts of the *Mersey Docks* case, and must be accepted for the purposes of any other case of a similar character. But I do not think they are applicable when dealing with a life insurance concern. It is of the very essence of such an enterprise that a portion of the income should from time to time be invested in order to create and maintain a fund capable of meeting the liabilities that have been and are being created. To treat and distribute as profits all the income in excess of the costs and expenses of receipt and collection would soon land such an undertaking in hopeless insolvency.\(^{133}\)

Lord Herschell's observation was founded upon the view that an overemphasis upon the definition of income as 'receipts less working expenses' for the purposes of the *Income Tax Act* failed to take account of economic realities such as contingent expenditure associated with the derivation of income. Although he accepted that the doctrine of *stare decisis* precluded a reexamination of the issues raised in the earlier case law, Lord Herschell's observation was a significant indication that at least some judges were conscious of the commercial implications of their decisions. Further, Lord Herschell indicated
that there may be some room for the courts to manoeuvre within the 'receipts less working expenses' doctrine in order to produce more favourable outcomes to taxpayers.

This commercial awareness, and the preparedness of the courts to revisit the vexed issue of the relevance of accounting practice in the context of the income tax, was tested in *Gresham Life Assurance Society v Styles*. In that case an insurer sought to deduct certain annuity payments in calculating its profit for the purposes of the income tax, notwithstanding the apparently express exclusion of such a deduction in Rule 4 of Case 1, Schedule D. The court was therefore required to determine whether this exclusion had any operation. The Court of Appeal cited *Alexandria Waterworks Company* as authority for the proposition that 'profits' meant gross receipts. On this basis the court held that the exclusion of deductions for annuity payments did have an operation because the reference to 'profits' did not allow any deduction for the annuity expense. On appeal to the House of Lords, the decision of the Court of Appeal was overturned on the basis that the reference to 'profits' was to be accorded its 'ordinary' meaning. According to the House of Lords, this meant that in the case of a company trading in annuities, the cost of such annuities was properly taken into account in ascertaining taxable profits.

The decision of the House of Lords in *Gresham Life Assurance Society* contributed to the confusion concerning the definition of 'profits'. If the cost of

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133 *Styles*, above n 117, 483. Lord Herschell failed to consider that the directors or partners were not obliged to distribute all of the profits, and indeed that it might be prudent to retain some profits in a profit reserve in the circumstances he described.

134 (1890) 2 TC 633.

135 Rule 4 was expressed in these terms: 'In estimating the amount of the profits and gains arising as aforesaid no deduction shall be made on account of any annual interest, or any annuity or other annual payment, payable out of such profits or gains.'

136 'Now the question is, what is meant here by "profits or gains?" I think that by this is meant, receipts, trade receipts, on credit side of the account, and I think that this view is very much strengthened by the different phraseology used in these different rules'; 641 (Lopes LJ); see also: 640 (Esher MR) and 641 (Lindley LJ).
annuities was to be allowed in calculating profits in all cases, the decision of the House of Lords rendered Rule 4 otiose, as the rule was interpreted merely as restating the fact that, once the taxpayer's profits had been ascertained, the taxpayer could not claim a deduction with respect to any payment of interest or an annuity not connected with his or her income earning activities. Nevertheless, the House of Lords appeared to accept that Rule 4 did have some application, although just in what circumstances Rule 4 would or would not apply was not discussed by their Lordships. However it seemed clear, after *Gresham Life Assurance Society*, that notwithstanding the express prohibition in the Act, those trading in annuities had been spared from the impact of Rule 4. Further, the decision of the House of Lords in *Gresham* signalled the preparedness of the Lords to extend the 'working expenses' proviso in developing an income concept somewhat closer to the commercial concept of income than had hitherto been the case, notwithstanding what were apparently clear legislative exclusions of particular deductions.

According to the generally accepted account of tax interpretation, the courts merely discovered the literal meaning of the income tax legislation in a manner which stood in contrast to the discretionary administration of the income tax at the level of local government. However the literal meaning of 'profits and gains' for the purposes of the income tax of Victorian Britain is problematic. At no point was there a consensus upon the meaning of the income concept. Nowhere is this conflict between competing interpretations, and the evidence of judicial choice more apparent, than in the case law with respect to the meaning of profits or gains under Schedule D.

Although some early decisions adopted the economic concept of profit, in *Coltness* the House of Lords rejected this broad approach, preferring a more limited concept of income. In *Coltness* the House of Lords confronted the apparent inequity, in terms of substantive justice, of the differential treatment of profits under Schedules A and D. If the references to 'profits' throughout the
Act were understood to mean gross receipts. The House of Lords also confronted the apparent injustice, in terms of formal justice, of any attempt to ameliorate this horizontal inequity by 'judicial legislation'. The decision in Coltness ultimately represented a compromise between these possibilities. By adapting the 'technical' meaning of 'profits' from the Rating Acts, the House of Lords expanded the range of deductions allowable under Schedule A, while effectively rendering the express deduction rule of Schedule D otiose. Although there is no express reference to judicial pragmatism in the judgments in the House of Lords, the Coltness decision reflects a judicial awareness of the pragmatic implications of the competing interpretations of the income tax legislation.

However, rather than resolving the conflict between the accounting and technical understandings of ‘profits’, the compromise in Coltness merely perpetuated the conflict by incorporating them both within the ‘gross receipts less working expenses’ formula. Thereafter a line of authorities highlighted the judicial uncertainty regarding the relative weights to be accorded the technical and accounting concepts of profits when applying this compromise to particular circumstances. By excluding the cost of sinking pits from the category of working expenses, the Coltness decision had initiated a line of ad hoc judicial decisions influenced by a pragmatic judicial awareness of the operation of the legislation. Far from representing the discovery of law, the judicial interpretation of the income tax legislation in the 1880’s is characterised by pragmatic choices between plausible alternative interpretations. If anything, the preceding review of the case law demonstrates that the judges ‘discovered’ the plethora of income concepts adopted in various contexts by the wider community. There was no one literal meaning of the income concept awaiting judicial discovery.
G Judicial Pragmatism and the Cloak of Formalism

The second aspect of the mainstream account of tax interpretation is that the courts of the Victorian era uniformly adopted the rhetoric of strict literalism in construing the income tax legislation. Upon the basis of the authoritative declarations of the literalist method in cases such as Tennant v Smith, modern commentators have accepted that the judiciary uniformly adopted the literalist method over the closing decades of the nineteenth century. In the 1890’s, it has been suggested, the judicial rhetoric of formalism assumed a strident tone.137 This shift to a heightened rhetoric of formalism might also have signalled a shift in judicial practice. However, the creativity of the courts in this era of ‘new’ formalism is nowhere more clearly demonstrated than in Tennant v Smith,138 one of the decisions of the House of Lords which is often cited as authority for the literalist approach adopted by the courts of the Victorian era.

It will be recalled that while Schedules A, B, C, and E brought various flows to account as income, Schedule D brought ‘profits or gains’ to account. Case VI of Schedule D extended the tax net to ‘profits or gains’ not otherwise brought to account under the Act, and was the troublesome provision in what was, at least after Coltness, otherwise perceived as a theoretically consistent Income Tax Act.139 The possibility that the Act might apply to a broad range of profits depended upon the breadth of the interpretation adopted with respect to ‘gains’ under Schedule D, and particularly those gains falling under Case VI of that Schedule. In Russell (Surveyor of Taxes) v Aberdeen Town and County Bank140 the taxpayer carried on the business of banking, and leased premises for that

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137 Blackshield, above n 84.
138 [1892] AC 150.
139 The potential breadth of the United Kingdom income tax, by virtue of this inclusive provision in Schedule D case VI, is often overlooked by commentators who are perhaps too willing to draw a distinction between jurisdictions such as the United States and the United Kingdom; see, for example, R Haig, ‘The Concept of Income - Economic and Legal Aspects’ in R Musgrave and Carl Shoup (eds), Readings in the Economics of Taxation (1959) 54, 56; Krever, above n 56, 224 (n 23).
140 (1888) LR 13 App Cas 418.
purpose. A part of the premises were used by the bank manager as his private residence, for which the manager was not required to pay rent. The question before the House of Lords was whether the taxpayer was entitled to claim a deduction for the rental paid for the entire premises, or just that part which was not devoted to the private use of the manager. In finding for the taxpayer, Lord Herschell suggested that the provision of premises rent free constituted a gain to the manager which may be assessable as an emolument under Schedule E.

Perhaps emboldened by this obiter statement of Lord Herschell, the Surveyor raised the case of Tennant v Smith. In that case a bank employee was allowed to occupy a part of the bank premises for residential purposes on the understanding that he would attend to the security of the building outside of banking hours. The employee was not allowed to vacate or sublet the premises without the consent of the Bank's directors. No deduction was made from the employee's salary in consideration for the occupation of the bank premises. The Surveyor maintained that the annual rental value of the accommodation provided to the employee ought be included in his income for the purposes of the Act, relying upon the alternative grounds of Schedules D and E.

The opening words of Lord Halsbury's judgment did not bode well for the Surveyor:

My Lords, to put this case very simply, the question depends upon what is Mr. Tennant's income. This is an Income Tax Act, and what is intended to be taxed is income. And when I say "what is intended to be taxed," I mean what is the intention of the Act as expressed in its provisions, because in a Taxing Act it is impossible, I believe, to assume any intention, any governing purpose in the Act, to do more than take such tax as the statute imposes.

141 (1892) AC 150; 3 TC 158.
142 Ibid 163.
His Lordship adopted the literalist canon that 'you must see whether a tax is expressly imposed' and noted that under Schedule E the subject of taxation was only those emoluments, perquisites and profits which were 'payable' to the taxpayer. On the basis that the saving of an expense could not constitute a payment, his Lordship held that Schedule E was inapplicable to the facts before him. No consideration was given to the possibility that the provision of rent free accommodation constituted a constructive payment. Notwithstanding the express reference to the literal rule by Lord Halsbury, his Lordship dismissed the suggestion that Case VI of Schedule D applied, on the basis that the taxpayer could only be assessed under Schedule E. Lord Watson offered the rationale for this exclusion of Case VI:

It appears to me that everything in the shape of profit or gain arising from a public office or employment, which the Legislature intended to be chargeable with duty, is ascertainable and assessable under the rules of Schedule E, and under these rules only.

No statutory foundation for this conclusion was recorded by Lord Watson. In particular, he did not reconcile his conclusion with the existence of Case VI of Schedule D, which seemed to clearly contemplate that some assessable gains would fall outside of the other Schedules.

The decision of the House of Lords ultimately rested upon the question of which of two inconsistent provisions to apply. On the one hand, by taxing remuneration, perquisites and other benefits payable to an employee, Schedule E could have been categorised as the more specific provision which detailed a comprehensive code for the taxation of employees. By implication, any other benefits provided in association with the employment would not be included in the taxpayer's income for tax purposes. On the other hand, Schedule E could have been interpreted as applying specific rules to amounts payable to

143 Ibid.
employees, leaving the taxation of other benefits provided to employees to the general rules of Case VI of Schedule D. A plausible ‘literal’ reading of the legislation might therefore have, at the least, accepted that Case VI of Schedule D could apply to the provision of rent free accommodation to an employee. Had this been the case, Lord Herschell’s comment in Aberdeen and Town and Country Bank and also Lord Halsbury’s observation in Styles v New York Assurance that the participating policyholders had benefited from a more valuable contract might have lead to the conclusion that Smith had actually derived a gain which was liable to income tax.

The House of Lords was therefore confronted with at least two plausible approaches to the interpretation of the income tax. Although Lord Halsbury referred to the rule of strict construction, he opted for an interpretation of the Act which was founded upon the perceived ‘scheme’ of the legislation. Lord McNaghten expressed the rationale underlying the decision of the House of Lords when he abandoned any pretensions to a literal analysis of Schedules D and E, and referred to an underlying concept of income which his Lordship discerned in the legislation:

In my opinion the answer to the claim of the Crown does not depend on any minute criticism of the language of the different schedules. The real answer is that the thing which the Crown seeks to charge is not income, nor is it required to be taken into account as income.145

It is difficult to see how this statement can be reconciled with a literalist interpretative methodology purportedly adopted by the Court, as Case VI of Schedule D was apparently ignored on the basis that it did not fit within the judicial construct of ‘income’. Nowhere in Tennant v Smith is there any convincing explanation for why Case VI of Schedule D, interpreted regardless of any underlying concept of income, would not apply to the circumstances of

144 Ibid 168.
the taxpayer. If Tennant v Smith stands for the proposition that tax legislation ought be construed literally, as many commentators suggest, the actual decision of the case seems to support the conclusion that it is a peculiarly creative form of literalism which was embraced by the courts. This pragmatic judicial interpretation of one of the core concepts of the Victorian income tax suggests that the courts were doing anything but applying the literal meaning of the legislation in an era when literalism was purportedly at its zenith. The creation of the statutory right of appeal had purportedly heralded a new age of tax administration according to law, as opposed to the discretion of the local administration, but had merely served to create a new forum for the pragmatic application of the income tax.

G The Diversity of Interpretative Method in Victorian Income Tax Cases
Indeed, this pragmatism of the courts is also evident in the diversity of interpretative rhetoric adopted by the courts. A review of the case law suggests that the judiciary adopted a wide range of interpretative rhetoric over the closing decades of the nineteenth century.

1 The Plurality of the Literalist Concept
Although a number of judges had adopted the axiom that the interpretation of tax legislation required nothing more than the identification of the determinate literal meaning of the legislation, there was no elaboration upon what was meant by the literal meaning of the statutory words. It is clear from the preceding discussion of the early income tax case law that there was any number of standpoints from which the meaning of particular statutory words could be construed, and that often several quite disparate meanings were plausible. Thus even if a judge was prepared to accept the literalist rhetoric, the ‘literal meaning of the statutory words’ was itself a much more ambiguous concept than was

145 Ibid 170.
recognised within such statements of the interpretative principle. The courts implicitly acknowledged the plurality of the concept of ‘literal meaning’ by adopting the alternative standpoints of the technical meaning,\textsuperscript{146} the ordinary meaning,\textsuperscript{147} the commonsense meaning,\textsuperscript{148} and the accounting or commercial meaning\textsuperscript{149} of the statutory words. This plurality was recognised throughout the period when the courts were purportedly adopting the one literal meaning of the statutory words.

2 The Recognition of Alternative Interpretative Methods

(a) Substantive Justice

In addition to the plurality of the concept of ‘literal meaning’, in some judgments of this period the courts expressly accepted that the interpretation of tax legislation should be undertaken with the object of identifying the ‘just’ or ‘fair’ result. The concept of justice was itself open to alternative interpretations. This acknowledgement of a role for considerations of substantive justice therefore represented an implicit acceptance of the ‘golden rule’ of statutory interpretation in the context of tax interpretation.\textsuperscript{150} From the standpoint of substantive justice, many judges indicated that statutory interpretation entailed the evaluation of alternative interpretations from the perspective of principles founded upon communal morality. For example, Kelly LCB in \textit{Calcutta Jute}
Mills Co Ltd v H. Nicholson and Cesena Sulphur Co Ltd stated that the 'great principle of the Law of England in relation to taxation is that taxation shall only be imposed upon persons or things actually within this country.'

In the context of tax legislation of general application, Lord Ardmillan suggested that such principles overrode the literal rule of statutory construction:

There is no doubt that an Act which taxes is to be strictly construed. Where there is an Act taxing a particular body, or laying a tax upon a particular article, of course that Act is to be strictly construed, but where there is an Act taxing the whole of Her Majesty’s subjects, and the question is, whether it is to be construed so as to sustain the equality of the incidence of the tax, I think there is no presumption in favour of that exemption and against the equality of the incidence of the taxation. It is the next and soundest principle of taxation to be as equal as possible, and I cannot recognize, as a presumption against that equality, what has been urged today.

Even in the closing years of the nineteenth century, at a time which is commonly portrayed as the zenith of the literalist methodology in the English courts, the House of Lords accepted that the literal interpretation of a particular statutory provision would produce an 'unreasonable' result and therefore sought an alternative interpretation which would better achieve 'justice'. One example of this preparedness to embrace notions of substantive justice in rejecting what was understood to be the literal interpretation may be seen in Colquhoun v Brooks. In that case the taxpayer was assessed under Schedule D as a

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151 1 TC 83, 92.
152 Re Young (1875) 1 TC 57, 62. Also see the judgment of Lord Dens: '[w]e are here dealing with a statute which lays a tax on a whole population who are in the particular position to which it refers, a war tax ...That is the sort of tax I take it to be, and, although a taxing Act upon particular classes of individuals has to be very strictly construed, we must keep in mind in administering an Act of this kind that the great principle comes in that there is to be equality of liability among all the parties for whose benefit it is laid on. Therefore, although this is a taxing Act, I think there is no more inference to be drawn from that in favour than against liability.'

Also see the judgment of Lord Ardmillan in Re Scottish Widows Fund and Life Assurance Society (1875) 1 TC 7, 10. This was a case involving the inhabited house duty, but Lord Ardmillan considered that the principle of equality overrode the principle of strict construction.

153 (1889) LR 14 App Cas 493.
resident who had derived profits from carrying on a trade in Australia. The taxpayer was a partner in an Australian partnership which had generated substantial profits, but only a portion of the taxpayer's share in those profits had been remitted to him whilst he resided in the United Kingdom. The issue was therefore whether the terms of Schedule D applied to just that portion of profits remitted to the taxpayer, or whether they applied to the taxpayer's entire share of the partnership profits.

Although he concluded that the relevant provision did not make the entire share of the profits liable to the tax, Lord Herschell conceded that:

> It must be admitted that the words of the statute do prima facie support his contention. For, notwithstanding the ingenious criticisms to which they have been subjected by the learned counsel for the Respondent in their able argument, I think that, giving to the language of the enactment its natural meaning, the facts stated do apparently bring this case within it.\[^{154}\]

A similar concession was made by Lord Lindley in the case of *Attorney General v London County Council*,\[^{155}\] while in *Gresham Life Assurance Co v Styles*\[^{156}\] a similar concession might quite easily have been made. In both cases the House of Lords ultimately decided in favour of the taxpayer upon the basis that adoption of the 'natural' or 'literal' meaning of the statute would produce an 'unjust' or 'unreasonable' result. This conclusion was supported by the view that the natural meaning of the relevant provision conflicted with the natural meaning of other provisions in the Act which, it was thought, could not have been the legislative intention.\[^{157}\] In these cases the courts clearly acknowledged

\[^{154}\] Ibid 498.
\[^{155}\] (1900) 4 TC 265, 303.
\[^{156}\] (1892) 3 TC 185.
\[^{157}\] For a discussion of the mechanistic rhetoric adopted by the English courts while they nevertheless engaged in pragmatic lawmaking in the late Victorian and the Edwardian eras, see: B Abel-Smith and R Stevens, above n 84, 121-5.
that it would have been open for the court to adhere to the literal meaning, but chose not to do so on grounds of substantive justice.

Other judges were less willing to countenance such a clear juxtaposition of formal and substantive justice, preferring instead to explore the possibilities for accommodating substantive and formal interpretative methodologies within the one theory of interpretation. Thus in *Forder v Handyside and Co Ltd*\(^\text{158}\) Pollock B observed:

\[
\text{Strictly speaking, there is no difference between what is called an equitable construction of an Act and any other construction. It appears to me that upon the most favourable and just construction of this Act of Parliament for the Respondents...}^{159}
\]

An alternative compromise between the formalist and substantive conceptions of justice was to give greater emphasis to formalist notions of justice by acknowledging that the function of the courts was to identify the principle of the legislation as a whole. Thus, in *Colliness* the Lord President in the Scottish Court of Exchequer stated that:

\[
\text{The general principle of the property and income tax to which effect is given by the statutes is, that everything of the nature of income shall be assessed, from that source soever it may be derived, whether from invested capital, or from skill and labour, or from a combination of both and whether temporary or permanent, steady or fluctuating, precarious or secure. Nor does it make any difference on the incidence of the tax that the income has been created by the sinking of capital, as in the case of the purchase of annuities, instead of being merely the natural annual product of an invested sum which remains unconsumed and undiminished by the consumption of the income which it yields.}^{160}
\]

Aside from this quest for the principle of the legislation as a whole, the Lord President also appealed to a literalist methodology by noting that the specific

\(^{158}\) (1876) 1 TC 63.

\(^{159}\) *Forder v Handyside and Co Ltd* (1876) 1 TC 63, 69 per Pollock, B.
exclusions from deductions in Schedule D indicated that the 'balance of profits' in Rule 1 of Schedule D did not mean accounting profits, but rather a species of profits unique to the income tax:

Any other construction of the statute would not only be inconsistent with the leading principle on which it is based and with its express words, but would lead to very embarrassing consequences.\textsuperscript{161}

Although the decision in \textit{Colness} acknowledged that the meaning of the legislation was discernible in the statutory document itself, it is nevertheless indicative of the ambivalence of the courts towards the literalist methodology. The recognition of three interpretative methodologies in this last extract; the quest for the principle of the legislation, the identification of the meaning of the express words and the consideration of pragmatic consequences, suggests that even those judges willing to embrace a formalist interpretative rhetoric often only tentatively endorsed the rhetoric of literalism in the sense of the straightforward application of the acontextual meaning of the statutory words. Throughout the judgments of the Victorian era, the British courts frequently adopted the rhetoric of substantive justice to varying degrees, in apparent contravention of the literalist methodology commonly attributed to the courts of this era.

\textit{(b) Judicial Reference to the Legislative Intention}

Further, in another contravention of what is commonly portrayed as the axiom of literal interpretation, in a number of cases the courts also expressly referred to the legislative intention as a basis for their decisions, although there was little elaboration upon the nature of this intention or how the legislative intention was

\begin{footnotesize}
\textsuperscript{160} \textit{Colness Iron Co v Black} (1881) 1 TC 287, 306.
\textsuperscript{161} Ibid 308.
\end{footnotesize}
to be ascertained. Thus there was passing reference to the spirit of the legislation and to the intention of the statutory words.

H Conclusion - Reconciling the Rhetoric of Legal Determinacy with the Reality of Legal Indeterminacy

The generally accepted depiction of the interpretation of the income tax in the late nineteenth century maintains that the courts adopted a strict literalism in interpreting the legislation. These commentaries are founded upon two related propositions. Firstly, that there was one determinate 'literal' meaning of the legislation. Secondly, that the rule of strict or literal construction was uniformly applied to the interpretation of income tax legislation in Victorian Britain. These propositions appear to be justified by those cases where the strict construction rule was expressly referred to, such as *Tennant* and *Partington*, and also by the wealth of contemporary secondary literature supporting the view that the courts applied the literal meaning of tax legislation.

However, the preceding discussion of the income tax case law of the period 1875 to 1900 suggests that the interpretation of the income tax was founded upon anything but a mechanical application of the literal meaning of the legislation. With respect to the substantive meaning of the income tax legislation, it is clear that there were several differing conceptions of income used in differing contexts in the Victorian era. Further, it seems that the legislature had incorporated these differing conceptions of income into the legislation itself. Having chosen the view that the legislation imposed a tax

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162 *Blake v Mayor of London* (1887) 2 TC 209 cf *St. Andrews Hospital v Shearsmith* (1887) 2 TC 219.
163 *Mersey Loan and Discount Co v Wootton* (1887) 2 TC 316, 319 (Pollock B).
164 *Coltness Iron Co v Black*, 317; *Attorney General v London County Council* (1899) 4 TC 265, 302-303 (Lord Lindley).
166 Above n 1.
liability upon ‘income’ rather than a disparate array of receipts which need not necessarily share any common characteristics, the courts were placed in the difficult position of attempting to reconcile the competing concepts of income reflected in the income tax legislation. At times the courts adopted the standpoint which maintained that income was synonymous with the technical meaning of profits, at other times the courts adopted the commercial and accounting standpoint in framing an alternative concept of profit, and occasionally some judges even adopted an economist’s standpoint in adopting a concept of ‘real’ gain. A review of the case law suggests that, rather than identifying the one determinate concept of income according to its literal meaning, the courts wrestled with the contradictions inherent within the ad hoc legislative scheme in their efforts to construct a coherent concept of income.

Even if there were determinate literal meanings of key elements of the tax such as the income concept, it is apparent that the courts did not uniformly apply the literal meaning of the legislation. In various cases judges referred to literalism, ordinary meanings, commercial understandings, legislative intention, ‘just’ outcomes, the ‘equitable construction’ of legislation and ‘great principles of taxation.’ It is clear that these alternative standpoints gave rise to a wide range of possible outcomes. Rather than resolving any doubts about the meaning of legislative terms, the ‘methods’ of statutory construction adopted by the courts merely emphasised the legislative polysemy. Indeed,

167 Gresham Life Assurance Society v Styles (1890) 2 TC 633, 639-40 (Esher MR); Aikin v The Trustees of the late C.M. MacDonald (1894) 3 TC 306, 308 (Lord Adam).
168 Lord Mostyn v London (1894) 3 TC 294, 296; Grainger v Gough (1896) 3 TC 462, 472 (Lord Morris); Gresham Life Society v Bishop (1902) 4 TC 464, 476 (Lord Lindley); Crookston Bros v Furtado (1910) 5 TC 602, 620 (Lord Salvesen).
169 Crookston Bros v Furtado (1910) 5 TC 602; Attorney General v London County Council (1899) 4 TC 265, 302-303 (Lord Lindley): ‘Section 24, clause 3, must be read with them, and, so far as its language permits it must be so construed as to accomplish its special object, and produce with them results which are in conformity with the principles on which they are framed, and with the scheme of taxation contained in their provisions. The construction to which I have alluded appears to me to be quite inconsistent with those principles and with such a scheme. It introduces anomalies which are startling and irrational, and which there is no reason to suppose that the Legislature ever contemplated.’
the case law of this period suggests that judges consciously or subconsciously chose between these alternative standpoints in what was perceived to be a search for a 'just' result. Whilst the Victorian era is perhaps rightly identified as the watershed of the modern rhetoric of legal determinacy, the interpretative practice of the period was anything but consistent with the rhetoric.\textsuperscript{170}

Given that the courts were adopting any number of interpretative rhetorics and that there was considerable uncertainty surrounding such core concepts as that of 'income', the question arises as to how the judicial statements of the strict construction rule were promoted above all others such that they were accepted as accurate depictions of the interpretative methodology adopted in tax cases. In response to this problem, some suggest that the courts were cynically engaging in a hard fought public relations exercise in which the legitimacy of 'the legal institution' was threatened by, for example, the utilitarian critique of the legal system.\textsuperscript{171} Alternatively, it is suggested that the courts were merely captives of the dominant ruling class 'superstructure' and therefore oracles for the ideology of the middle class.\textsuperscript{172} Both of these accounts, however, lack an explanation of why it was that the judicial rhetoric of legal determinacy was apparently accepted by a significant number of contemporary commentators. In other words, if the courts were under attack from a number of critics, why did people not see through the rhetorical web of legal formalism woven by the courts? Rather than explaining this phenomenon by a social theory founded upon the ignorance of the masses and the cynicism of an elite, it might be suggested that

the shift in rhetoric to the construction of tax legislation according to legislative intent and literal meaning should be understood as an account of interpretative method which appeared plausible to a wide cross section of the nineteenth century British community. Such an account does not have to accept that the objectivist rhetoric of the courts was ‘right’ - all that needs to be explained is why this objectivist account was plausible at the time.

For some time the courts and lawyers had developed the objectivist theory of law in analogising law to science - the law was ‘out there’ awaiting discovery by the application of the appropriate legal scientific method.173 Perhaps this assimilation of law with science was a cynical appeal by lawyers for legitimacy, or perhaps it merely reflects the significance to the Victorian mind of modern science as the source of solutions to all sorts of social and physical problems. Whether or not this analogy of law to science represented an accommodation of utilitarian criticisms of the law, and hence just one more phase in the struggle for legitimacy of the legal institution, it is clear that the characterisation of law as a science affected the way in which the law was perceived in the late

Victorian era. The ‘science of law’ enabled the portrayal of legal problem solving in terms of an objective process of discovering the objective facts, distinct from ethical and moral considerations. Accordingly, lawyers were understood to focus upon objectively observing what the one right answer was.

The prevailing, referential theory of language combined powerfully with this characterisation of law as science. Statutory interpretation could be characterised as a process of discovery of meaning rather than the creation of meaning. Although there was an undercurrent of pragmatic dissent, in the latter stages of the nineteenth century the existence of legal determinacy was rationalised upon the basis that language afforded an objective means of naming objects in an objectively discernible world. The referential theory of language was therefore a key component of the ‘slot machine’ jurisprudence characterised by epithets such as ‘think things not words’.

The rhetoric of objectivism was also bolstered by the rhetoric of individual rights which was so fundamental to the English psyche. In the new era of broader parliamentary franchises and the ‘creeping socialism’ of the incipient welfare state, this rights discourse assumed a new significance to the propertied classes. People of property felt increasingly alienated from what had been

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174 See, for example, CS Pierce, ‘How to make our ideas clear’ (1878) 12 The Popular Science Monthly 276.
175 See, for example, JS Mill, A System of Logic (1947) pp 48-9. As Kelly has noted, the naming theory of language had generated a form of literalism in Roman times; John Kelly, A Short History of Western Legal Theory (1992) 51.
'their' state, and considered that they were compelled to stand in line with 'the masses' for any benefits provided by the state. John Stuart Mill’s essay ‘On Liberty’ and Dicey’s interpretation of its precepts reflects this shift to a ‘boundary theory’ in which the interests of individual and state were treated in a less organic light than earlier versions of social contract theory which had prevailed in the eighteenth century. In the taxation context, this enhanced awareness of the rights of the individual is discernible in the nineteenth century rhetorical shift from the benefit theory of taxation to a theory founded upon equality of sacrifice. The benefit theory of taxation had reconciled taxation with social contract theory by equating taxation as the price paid under a contract for the purchase of state provided goods and services. When the survival of the new liberal political order had been tested by internal dissent and foreign powers over the eighteenth century, it is understandable that the benefits of taxation were given greater prominence by the eighteenth century commentators. However, by the mid nineteenth century Britain was riding the crest of its military and industrial wave. The self assurance fostered by this commercial and military power generated a greater sense of security in the political order, leaving scope for such indulgences as a greater emphasis upon the rights of the individual as against the claims of the state. The shift from the benefit theory of taxation to the rhetoric of equal sacrifice sponsored by John Stuart Mill reflects this attitudinal shift. Although it was not necessarily Mill’s intention, the rhetoric of equal sacrifice suggests that taxes were no longer seen

in terms of a purchase of a social good (ie the survival of the liberal political order) but rather were perceived as confiscatory.

The professionalisation of the tax bureaucracy and the consequent diminution of the power of the local income tax administration, the recognised permanence of the income tax and the emergence of the graduated tax agenda\textsuperscript{183} were phenomena which only served to reinforce the conservative depiction of a more effective state apparatus which had turned upon the property rights which, to many, it was created to protect.\textsuperscript{184} To social conservatives there was an alarming trend towards the use of the income tax to redistribute wealth from the wealthy to the poorer members within the community. In 1899 the then Chancellor captured the growing alarm of the wealthier classes towards this emergence of the rhetoric of 'state socialism' when he commented:

I daresay I am old fashioned in my ideas but I look with alarm on the tendency of the present day quite irrespective of political opinion ... to look to the Exchequer and the Central Government in all kinds of departments of life, in all kinds of relations between individuals in which, in the old days, the Government of the country was never deemed capable of acting at all.\textsuperscript{185}

\textsuperscript{183} For discussion of the development of calls for a graduated income tax see: F Shehab, \textit{Progressive Taxation} (1953).
\textsuperscript{184} For discussion of this point see chapter 1 under the heading 'Taxation and the Liberal State'. The proposition that the state was created to protect property underpinned the mid nineteenth century calls for reform of the income tax so that it imposed liability upon the capitalised wealth of the individual. The nexus between the ownership of property and the liability to tax was therefore the linchpin of such calls; see, for example, the evidence presented by Mr Farr, \textit{Second Report from the Select Committee on the Income and Property Tax}, above n 26, 236-7.
\textsuperscript{185} United Kingdom, House of Commons, Hansard, 13 April 1899, 1006 (Sir Michael Hicks-Beach, Chancellor). Indeed, in 1799 it had been generally understood that the government was incapable of imposing a graduated income tax, on the basis that it could only tax incomes rather than regulate them; Anon, \textit{Review of the Arguments Advanced in the house of Commons in Support of the Bill Granting an Aid and Contribution ... by Imposing Certain Duties upon Income} (1799) 14.
It is clear that this perceived dichotomy of the interests of the individual and the state was not unanimously accepted in the nineteenth century. However, for present purposes, it was significant that the discourse of rights deployed by social conservatives, and property rights in particular, was considered to require a reconfiguration of the judicial role in terms of the protection of individual rights from encroachment by the executive arm of government.

The rights discourse, however, was not solely the discourse of social conservatives. The discourse of rights had also been adopted by those advocating the extension of the franchise and the development of the welfare state. The bipartisan character of the rhetoric of rights invested it with substantial rhetorical power in the late nineteenth century English community, and it is for this reason that the rhetoric of rights played a vital role in the legitimation of the strict construction rhetoric. The legalist rights discourse was perceived as a powerful bulwark in the protection of individuals from administrative discretion. The ‘rule of law’ served to emphasise the importance of the courts in protecting the rights of individuals to retain private property from the grasp of the state, presumably on the assumption that private property was more productive than public expenditure.

Finally, the nineteenth century had seen the gradual extension of the franchise under the Reform Acts, lending some weight to the view that a representative Parliament was properly the only lawmaker under the English constitution. The rhetoric of respect for the democratically based sovereign power of parliament was therefore another vital element in contemporary portrayals of the law applying, as opposed to law creating, function of the courts.

186 Note the developing ideology of the welfare state, which placed greater emphasis upon the characterisation of the state as the servant of the people rather than an oppressive alternative power; see: Eric Evans, Social Policy 1830-1914: Individualism, Collectivism and the Origins of the Welfare State (1978).
The rhetoric of objectivism, when combined with the rhetorical discourses of legal science, legal rights and the separation of powers under a parliamentary democracy was partially engendered by, and also engendered, a powerful vision of statutory interpretation which stifled suggestions that the courts were merely another political forum. Just as the objectivity of science was widely assumed in the late Victorian era, so the separation of law from politics under an objectivist theory of law was the 'natural' understanding of 'the law' and the legal process. The strongest version of this determinacy thesis was the rule of strict literal construction, and so it is not surprising that at times judges would refer to it. It is also perhaps understandable that contemporary commentators, in search of the 'one true principle' of statutory construction in tax cases, overlooked the intricate web of interpretative rhetorics adopted by the courts, and instead focused upon the strongest version of what, in the context of the day, appeared the most plausible theory of interpretation.

187 Reforms to the franchise and system of political representation were undertaken in 1832, 1867 and 1884-1885; women would have to wait until the Representation of the People Act 1918 and its amendment in 1928 before winning the same franchise as men.
CHAPTER FOUR - THE JUDICIAL INTERPRETATION OF THE COMMONWEALTH INCOME TAX - COMPETING DISCOURSES AND THE RHETORIC OF LEGITIMACY

A Introduction

In chapter three it was argued that the judicial interpretation of tax legislation in Victorian England has been inappropriately characterised as strictly literalist, notwithstanding the judicial pronouncements which appeared to justify the depiction of a judiciary preoccupied with strict literalism. According to the generally accepted account of tax interpretation, the British courts continued to adopt this literalism until undergoing a sea change in the 1970s. Similarly, the Australian courts are generally understood to have followed the English jurisprudence in adopting a literalist approach to the interpretation of tax legislation.¹ For present purposes it is significant that the foundation of this portrayal of the interpretation of the Commonwealth income tax prior to 1980 is that the judicial rhetoric regarding statutory interpretation is taken at face value. Once again, then, it is assumed that there was a literal meaning and that the literal meaning was discovered by the courts. The interpretation of tax legislation in the first seven decades of the twentieth century is therefore portrayed in formal terms, a depiction which excludes any role for the context in which the legislation was interpreted. The purpose of this chapter is to continue

¹ See material referred to in n 29, chapter 1. This incorporation of the British jurisprudence upon statutory interpretation is understandable for two reasons. Firstly, the reception of English law into Australia upon settlement of each colony under the doctrine of terra nullius was generally understood to mean that English legal doctrines held a special place within Australian law; see: State Government Insurance Commission v Trigwell (1979) 142 CLR 617, 625-6 (Gibbs J). It was only in Parker v The Queen (1963) 111 CLR 610 that Dixon CJ expressly challenged the High Court's subservience to English authority. Secondly, the Privy Council retained its appellate jurisdiction with respect to Australian federal taxation matters until 1968; Privy Council (Limitation of Appeals) Act 1968 (Cth). Given that the Privy Council considered itself bound by House of Lords decisions (see, for example, Robins v National Trust Company [1927] AC 515, 519), it understandably preferred British principles of statutory interpretation when called upon to interpret Australian taxation legislation. In this context, it is also understandable that the Australian courts adopted the prevailing British theory of statutory construction.
the critical appraisal of this depiction of literalist tax interpretation in the context of the judicial interpretation of Australian tax legislation prior to 1980.

B The Introduction of the Commonwealth Income Tax

The introduction of the income tax in Australia was heralded by a tax upon dividends imposed by the Tasmanian Parliament in 1880.\(^2\) Over the next quarter of a century financial necessity drove the respective State Parliaments to introduce various forms of an income tax.\(^3\) South Australia was the first state to introduce an income tax with a relatively broad tax base, the tax being imposed upon 'all incomes arising or accruing in, or derived from, South Australia'.\(^4\) Subsequent income tax legislation introduced in the respective states adopted a similar tax base, the tax being imposed upon 'all incomes' arising in the particular state.\(^5\)

Just as wartime exigencies had precipitated the income tax in England during the Napoleonic wars, so the first world war compelled the Commonwealth government to raise additional revenue, and a number of considerations lead the Commonwealth government to impose an income tax.\(^6\) Many of the

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\(^2\) *Real and Personal Estates Duties Act 1880* (Tas) - the Act only imposed tax upon dividends distributed by public companies, annuities and rentcharges.


\(^4\) *Taxation Act 1884* (SA) s 9.


\(^6\) *Income Tax Assessment Act 1915* (Cth). Note that there were a number of options available to the government for raising the additional revenue, such as the imposition of a land tax or a wealth tax. For a discussion of the reasons for why the government settled upon an income tax, see: Smith, above note 3; see also the Attorney-General's Second Reading Speech to the Bill
fundamental features of the state income tax legislation were adopted in the Commonwealth income tax. Some of these features included the general taxing provision which imposed taxation upon income derived from sources within Australia, provisions exempting similar types of income or categories of taxpayers from the tax, the specific statutory additions to the income tax base and the general deduction provision. However there were significant differences between the Commonwealth income tax and the state income taxes. The most notable of these differences was the attempt to combat what was perceived to be illegitimate tax avoidance by a number of measures including the grant of administrative discretions to the Commissioner of Taxation, the enactment of a general anti-avoidance provision and the progressive income tax rate structure which had been framed with an eye to preventing income tax avoidance. Whilst the Commonwealth income tax legislation was to some

introducing the income tax: Commonwealth, Parliamentary Debates, House of Representatives, 18 August 1915, 5844 (Hon W M Hughes, Attorney-General).

7 Income Tax Assessment Act 1915 (Cth) ss 10, 14.

8 For discussion of which see: Commonwealth, Parliamentary Debates, House of Representatives, 1 September 1915, 6547-51 (Mr Watt and Mr Hughes, Attorney General).


10 For a more detailed comparison of the Commonwealth and State income taxes see: Robert Ewing, Taxes and Their Incidence (1926).

11 Examples of such administrative discretions within the Income Tax Assessment Act 1915 (Cth) included:
1. under s 14(e) the taxpayer was to include 5% of the capital value of land and improvements thereon used as the taxpayer’s residence or enjoyment ‘less the interest paid on a mortgage of that land, if the taxpayer satisfies the Commissioner that the mortgage was entered into in good faith;’
2. under s 16 companies were required to distribute what the Commissioner considered to be a reasonable proportion of their profits to their shareholders; for discussion of this discretion by the Attorney-General see: Commonwealth, Parliamentary Debates, House of Representatives, 1 September 1915, 6593;
3. s 18(a)(e)(h)(j); and
4. s 20(g)(i).

12 Income Tax Assessment Act 1915 s 53. For brief discussion of this provision see: Commonwealth, Parliamentary Debates, Senate, 9 September 1915, 6757-8 (Senators Russell and Keating).

13 Commonwealth, Parliamentary Debates, House of Representatives, 1 September 1915, 6614-5 (Mr W Hughes, Attorney-General).
extent modelled upon the income tax legislation of other jurisdictions, the *Income Tax Assessment Act 1915* represented a unique income tax tailored to suit the demands of the Commonwealth polity of 1915.

1 *Conflicting Discourses and the Income Tax*

Perhaps the most striking difference between the Commonwealth income tax and the British income tax was that the Commonwealth legislation adopted a 'global' concept of income, rather than dealing with differing categories of receipts under a schedular system. In chapter three it was argued that the schedular scheme of the British income tax legislation had incorporated irreconcilable concepts of income which had rendered the interpretation of that legislation particularly problematic. It might be thought that, by adopting a global concept of income, the Commonwealth government had overcome this problem. However, beneath the veneer of a coherent concept of income apparently reflected in the global approach, the same polysemy of the income concept may be discerned.

In chapter three it was noted that by the closing stages of the nineteenth century, there was a substantial body of literature in the United Kingdom addressing a vast array of income tax reforms, including the differentiation of permanent and precarious incomes and the graduation of income tax rates.¹⁴ Such debates played a significant role in the introduction of the Commonwealth income tax. In framing the income tax the Commonwealth government necessarily made a host of political decisions upon matters such as the rules governing the measurement of income for the purposes of the legislation, whether the tax would be imposed at a flat rate or upon a progressive scale, the rate(s) of tax imposed, the scope of specific exemptions, the powers granted to the tax administration and the rights of taxpayers to a review of administrative

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decisions. In resolving these matters the government was compelled to take account of numerous competing discourses in producing a Bill which both achieved the desired fiscal objectives and was also politically acceptable. The perceived need to foster economic growth, appeals to the developing political philosophy underpinning the nascent welfare state, the formalist faith in 'rule book' legislation and the capabilities of a relatively small tax administration were perhaps the more significant of these discourses which not only attended the birth of the Australian income tax, but continued to influence the shape of the income tax over the first half of the twentieth century. A study of the influence of any one of these discourses upon the development of the income tax legislation would be a major task in itself, but for present purposes it is sufficient to briefly outline the nature of these influences and note some examples of their impact upon the income tax legislation over the first seventy years of its operation.

(a) Promoting Economic Growth and the Income Tax

Whether the state is portrayed from laissez faire or interventionist standpoints, it is generally accepted that one of the key functions of the state is to facilitate economic growth. One major influence upon the Commonwealth income tax has therefore been the perceived need to create a tax system which is sensitive to the imperatives of capital within a capitalist system. This concern to tailor the tax system to the needs of business people is apparent in the elimination of perceived anomalies and injustices affecting business people, and also in the creation of tax concessions for particular categories of business taxpayers. Several examples will serve to illustrate the significant role that this discourse has played in shaping the Australian income tax.

John Stuart Mill had noted that the taxation of a business person's capital was anathema to the concept of an income tax, as the diminution of a person's capital would only lead to a reduction in that person's ability to generate income.
and, therefore, operate to reduce the income of the nation.\textsuperscript{15} Mill's exclusion of capital from the income tax base resonated with the exclusion of capital profits from the income concept for accounting purposes.\textsuperscript{16} The desire to encourage business investment by adopting this accounting concept of income is reflected in the exclusion of accretions to capital from the income tax base in 1915, an exclusion which effectively survived until 1985.\textsuperscript{17} In introducing the \textit{Income Tax Assessment Bill} in 1915 the Attorney-General linked this exclusion of capital from the income tax base with the rhetoric of economic growth when he observed:

As the productivity of a country and its development depend mainly on the amount of capital invested in it, and the employment of that capital, it follows that income taxation must distinguish between that portion of wealth which is destined for the production of more wealth, namely, capital, and that portion over and above that destined for consumption, and in excess of the amount necessary to maintain the community, which may be called surplus consumption wealth ... One of the basic principles of this Bill, then, is the taxation of surplus wealth as distinguished from capital.\textsuperscript{18}

It has been argued that this statement does not support the proposition that capital profits were excluded from the income tax base.\textsuperscript{19} However, given the exclusion of capital profits under the judicial interpretation of the United

\textsuperscript{15} John Stuart Mill, \textit{Principles of Political Economy}, WJ Ashley (ed), (1923) 604 (bk 5, chap 2, sec 2). This concern is also apparent in the work of Sir Josiah Stamp, where he noted that one of the key imperatives of any tax system ought be a concern to ensure that the tax does not 'dry up' the tax base; Sir Josiah Stamp, \textit{The fundamental principles of taxation in the light of modern developments} (1921). Stamp's work was quoted with approval in Commonwealth, \textit{Second Report of the Royal Commission on Taxation}, Parl Paper No 1 (1922) 106.

\textsuperscript{16} For a discussion of which see: W Strachan 'The Differentiation of Capital and Income' (1902) 18 \textit{Law Quarterly Review} 274.

\textsuperscript{17} At which time the capital gains provisions of Part IIIA were introduced into the \textit{Income Tax Assessment Act} 1936 (Cth).

\textsuperscript{18} Commonwealth, \textit{Parliamentary Debates}, House of Representatives, 18 August 1915, 5844-5 (Mr Hughes, Attorney-General).

Kingdom and Australian colonial and state income taxes, and given the absence of any clearly stated statutory provision including such profits within the tax base, it may be concluded that capital profits were intentionally excluded from the tax base.

In other provisions of the *Income Tax Assessment Act 1915* the legislature also indicated its preparedness to incorporate accounting concepts of income within the statutory framework. The grant of deductions with respect to amortisation expenses, depreciation and the grouping of a taxpayer's losses in certain circumstances are all indicative of a legislative preparedness to modify the 'gross flows' concept of income in accordance with business understandings of an appropriate income tax base.

 Aside from this definition of the income tax base which accorded, in some respects, with the business concept of income, the legislature also granted a number of significant tax concessions to business taxpayers. Over the eighty years since the introduction of the Commonwealth income tax, the rhetoric of fostering capitalism is reflected in the provision of tax expenditures to

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20 For the suggestion that even in 1900 'income' had acquired a technical legal meaning, see: *Harding v Federal Commissioner of Taxation* (1917) 23 CLR 119, 130. The restricted nature of the judicial definition of income was alluded to by Rich J in *Bohemians Club v Acting Federal Commissioner of Taxation* (1918) 24 CLR 334, 338-9. For contemporary secondary consideration upon the technical meaning of income see: W Strachan 'The Differentiation of Capital and Income' (1902) 18 Law Quarterly Review 274; W Strachan, 'Economic and Legal Differentiation of Capital and Income' (1910) 26 Law Quarterly Review 40; W Strachan, 'Capital and Income (Lifeowner and Remainderman)' (1912) 28 Law Quarterly Review 175; W Strachan, 'Capital and Income Under the Income Tax Acts' (1913) 29 Law Quarterly Review 163.

21 R Fayle and I van den Driesen, above n 3.


23 *Income Tax Assessment Act 1915* s 18(e). For discussion of this provision, and its perceived shortcomings from the standpoint of the business community, see: Commonwealth, Third Report of the Royal Commission on Taxation, Parl Paper No 35 (1922) 157-9. For discussion of the question whether an allowance ought be made for wasting assets more generally, see ibid, 159-61.


25 A tax expenditure is an amount of tax revenue foregone by the government. The government might otherwise have raised more tax revenue, but chooses to exclude the revenue from the tax base upon policy grounds; for a general discussion of the tax expenditure concept and the
business taxpayers. Such tax expenditures included the exclusion of foreign source income from the income tax base, the exemption of profits from various activities such as gold mining, the allowance of generous deduction provisions to farmers and miners, the allowance of income averaging to primary producers and the provision of accelerated depreciation of business plant and equipment. Indeed, by 1950 the provision of such ‘tax expenditures’ was considered by the Commonwealth Committee on Taxation to have reached such proportions that it called for a moratorium upon them, recommending that industry assistance be provided by direct subsidies rather than through the income tax system. In a tacit recognition of the power of the discourse of promoting private investment, this call was not heeded, and despite some appraisal of tax expenditures in the Australian context see Richard Krever, above n 3, ch 1; for a discussion of the problematic nature of the tax expenditure concept see Boris Bittker, ‘A "Comprehensive Tax Base" as a Goal of Income Tax Reform’ (1967) 80 Harvard Law Review 925; Richard Musgrave, ‘In Defense of an Income Concept’ (1967) 81 Harvard Law Review 925; Charles Galvin, ‘More on Boris Bittker and the Comprehensive Tax Base: The Practicalities of Tax Reform and the ABA’s CSTR’ (1968) 81 Harvard Law Review 1016; Stanley Surrey and Hellmuth, ‘The Tax Expenditure Budget - Response to Professor Bittker’ (1969) 22 National Tax Journal 528; Boris Bittker, ‘The Tax Expenditure Budget - A Reply to Professors Surrey and Hellmuth’ (1969) 22 National Tax Journal 538.

26 This concern was also raised both in favour of and against taxing foreign source income, thereby preventing the exodus of Australian capital to tax havens or encouraging the import of foreign capital respectively; see: Commonwealth, Second Report of the Royal Commission on Taxation, above n 15, 107-108.

27 Section 23(0). In 1925 income from gold mining was made exempt, an exemption which survived for 60 years despite the abolition of the gold standard and intermittent criticism of this tax expenditure; see, for example, Commonwealth, Report on Taxation of Mining Industries, Parl Paper No 88 (1952) 6.

28 For a review of the measures in 1950 see: Commonwealth, Report on Assessment or Exemption of Incomes Derived from Primary Production, Parl Paper No 139 (1952).

29 Sections 17 and 18 of the original Act allowed for deductions for calls paid upon mining shares and the deduction of capital expenditure over the life of the mine. For a review of the concessions allowed to mining industries in 1950 see: Commonwealth, Report on Taxation of Mining Industries (Reference No 5), Parl Paper No 88 (1951).

30 For discussion of which see: Commonwealth, First Report of the Royal Commission on Taxation, Parl Paper No 147 (1921) 9. The report illustrates the preparedness of the Commissioners, and subsequently the legislature, to depart from commercial practice in adopting a system of income averaging for primary producers.

31 Now provided by Income Tax Assessment Act 1997 (Cth) Division 42.

pruning in more recent years, numerous tax expenditures survive to the present day.\textsuperscript{33}

It is therefore apparent that the perceived need to create an environment favourable to private investment has influenced the substantive elements of the Australian income tax. However, it cannot be said that the definition of the income tax base was undertaken in accordance with a one-eyed protection of the perceived interests of capital. Although the legislature had constructed an income tax base which, in many respects, adopted the concept of income for accounting purposes, there are many examples of a legislative departure from the accounting concept of income.\textsuperscript{34} Further, after the 1930's, the developing 'science' of economics propounded an alternative concept of income framed in terms of the taxpayer's change in net wealth plus consumption over the relevant accounting period.\textsuperscript{35} From the perspective of this alternative concept of income, the \textit{Income Tax Assessment Act} 1915 incorporated numerous inequitable features. For example, although capital gains were not included in the income tax base, it was also clear that no deduction was allowed for capital losses incurred by a taxpayer in the course of carrying on a business.\textsuperscript{36} Even after the insertion of the capital gains provisions into the income tax legislation,\textsuperscript{37} capital losses incurred by taxpayers are at best quarantined to be set off against capital

\textsuperscript{33} At the time of writing the business tax reform process was under way, and the status of many tax expenditures such as accelerated depreciation was not clear.

\textsuperscript{34} For consideration of the exclusion of allowances with respect to wasting assets, for example, see: Commonwealth, \textit{Third Report of the Royal Commission on Taxation}, above n 23, 159-61.

\textsuperscript{35} Henry Simons, \textit{Personal Income Taxation} (1938); for earlier elaboration of a similar concept of income which emphasised market power rather than psychic concepts of income see: Robert Haig, \textit{The Concept of Income - Economic and Legal Aspects in The Federal Income Tax} (1921) 7. The preference for concepts of income framed in terms of market power is explained by the desire to identify a quantifiable measure of income, a keystone to any 'science' of economics. For discussion of psychic concepts of income as opposed to market based concepts of income see: Victor Thuronyi, 'The Concept of Income' (1990) 46 \textit{Tax Law Review} 45, 53; T Chancellor, 'Imputed Income and the Concept of Income' (1988) 67 \textit{Oregon Law Review} 561, 580.

\textsuperscript{36} Richard Krever, 'Capital or Current: The Tax Treatment of Expenditures to Preserve a Taxpayer's Title or Interest in Assets' (1986) 12 \textit{Monash University Law Review} 49.
gains, \(^{38}\) and at worst ignored for tax purposes. \(^{39}\) From the standpoint of a business taxpayer, \(^{40}\) this disparity of treatment of capital gains and losses produces an injustice in that a taxpayer may have negative economic income, but have a significant income tax liability. \(^{41}\) Another example of the failure of the legislature to respond to what many business people perceived to be an inequitable income tax system is the perseverance with what was widely considered to be the double taxation of corporate profits after 1940, \(^{42}\) one consequence being that equity financing was widely considered to be severely disadvantaged until the introduction of the dividend imputation system in 1987. \(^{43}\) Other examples of perceived inequity with respect to the treatment of

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\(^{37}\) The capital gains provisions now comprise *Income Tax Assessment Act 1997* (Cth) Part 3-1, and took effect with respect to certain assets disposed of after 19 September 1985.  
\(^{39}\) It being necessary for the taxpayer to derive a capital gain before any capital loss can be set off against the gain.  
\(^{40}\) This is not to say that the treatment of capital losses is problematic only for business taxpayers. However, as many assets held by non business taxpayers are effectively excluded from the capital gains provisions (ie a taxpayer's principal residence, many personal use assets and motor vehicles), it is fair to assume that the inequity of quarantining capital losses is more keenly felt in the business community.  
\(^{41}\) For a somewhat dated, but nevertheless insightful, discussion of the perceived injustices of the Australian income tax from the perspective of the economic definition of income, see: Ross Parsons, 'Income Tax - An Institution in Decay?' (1986) 12 *Monash University Law Review* 77.  
\(^{42}\) For recognition of the view that taxation of corporate profits at the corporate and shareholder levels constituted double taxation see: Commonwealth, *First Report of the Royal Commission on Taxation*, Parl Paper No 199 (1933) 11; Commonwealth, *Report on Taxation of Income of Companies - Private and Non-Private - and of Shareholders*, Parl Paper No 143 (1952) 14 (Appendix A); Commonwealth, *Final Report of the Committee of Inquiry into the Australian Financial System*, Parl Paper No 208 (1981) ch 14. For criticism of the view that this double taxation was necessarily inequitable see: Ross Parsons, 'An Australian View of Corporation Tax' [1967] *British Tax Review* 14 (arguing that the effective rate of tax upon corporate profits is the appropriate measure to be considered in assessing the equity of a tax). While Parsons is right to point out that taxpayers paying tax at the top marginal rate of tax were favourably treated under the corporate tax system, it should be noted that lower income earners were disadvantaged by the double taxation of corporate profits.  
corporate distributions are the treatment of dividends in some cases\textsuperscript{44} and the treatment of distributions upon the winding up of a company.\textsuperscript{45}

While at times successive governments have relied upon the rhetoric of promoting business in introducing various tax measures or maintaining the status quo, it is also clear that the Commonwealth income tax legislation over the years reflects a considerable degree of ambivalence with respect to the favourable treatment of business investment. Many provisions may be understood in terms of the perceived need to foster business investment, but equally many other provisions are motivated by other imperatives.

\textbf{(b) The Nascent Welfare State}

The development of the Australian welfare state has been traced to the latter stages of the nineteenth century.\textsuperscript{46} One key aspect of this construction of the concept of the state, the philosophy of wealth redistribution, was apparent in the Commonwealth income tax legislation from the outset. The differential treatment of property and personal exertion income,\textsuperscript{47} and the imposition of tax under a progressive tax rate scale,\textsuperscript{48} demonstrate the significance of welfarist

\textsuperscript{44} The inequity of including dividends may be illustrated by an example. Assume that a shareholder who is not a share trader paid $10 for a share with a face value of $1, and that the company held accumulated profits from which it shortly afterwards declared a $7 dividend. It might be argued that the shareholder's economic position has not changed and yet the shareholder is liable to income tax upon the $7 dividend per share with no rebate for the tax already paid by the company. If the shareholder then sold the share for $3, the shareholder incurs a capital loss which is not capable of being set off against the dividend receipt. Even after the introduction of the capital gains provisions in 1985, the capital loss is quarantined such that it may only be set off against a capital gain if and when such a gain is derived by the taxpayer.

\textsuperscript{45} See: \textit{Income Tax Assessment Act 1936} (Cth) s 47(1A).


\textsuperscript{47} For a discussion of which see: Commonwealth, \textit{Second Report of the Royal Commission on Taxation}, above n 15, 89-94. This measure was repealed in 1953; \textit{Income Tax and Social Services Contribution Act 1953} (Cth).

\textsuperscript{48} The then Attorney-General, Mr W Hughes, stated that: 'The tax falls on the shoulders of the community in such a way as to bear most heavily on those who have an ample margin over and above that which is necessary to maintain themselves according to the station in which they live. [The Bill] calls on those who have the means, to pay according to their means.' Commonwealth, \textit{Parliamentary Debates}, House of Representatives, 18 August 1915, 5845. For further
philosophy in the framing of the income tax. The redistribution of wealth through the welfare state depended upon an accurate measure of wealth, and so it is understandable that there are repeated references throughout the official record to the perceived need to create an ‘equitable’ income tax base.\(^49\) As those advocating an income tax base which was closer to the concept of economic income gathered voice over the course of the twentieth century, advocates of the welfare state incorporated the economic concept of income within their calls for an equitable, broadly based income tax.\(^50\)

But the history of the income tax legislation suggests that this rhetoric of tax fairness was by no means a dominant discourse in the structuring of the income tax base, as at times the ideal of equity was clearly rejected or compromised by other ideals. One example of this ambivalent treatment of the concept of tax fairness may be seen in the treatment of cash prizes in the first years of the income tax. In 1915 Parliament had included cash prizes within the income tax net,\(^51\) but in 1919 such prizes were excluded from an individual’s income but taxed under the \textit{Income Tax Act} 1919 at the source at a flat rate.\(^52\) The effect of this provision was to take such winnings outside of the graduated income tax

\(^49\) See, for example, Commonwealth, \textit{First Report of the Royal Commission on Taxation}, above n 30, 7-8.

\(^50\) These calls for root and branch reform are reflected in: Commonwealth, above n 43, ch 7; Commonwealth, \textit{Reform of the Australian Taxation System}, Parl Paper No 315 (1985); RI Downing, HW Arndt Boxer AH and Mathews RL, \textit{Taxation in Australia - Agenda for Reform} (1964). As already noted, business advocates also relied upon economic concepts of income, on occasion, when promoting various tax reform options, but were often less concerned with the broadening of the income tax base in accordance with the precepts of economic income. The concept of economic income was therefore selectively applied in accordance with the agenda of the advocate. Further, it should be noted that the concept of economic income is itself problematic, as there is no unanimity upon the application of the concept to such mundane matters as human capital; Jennifer Brooks, ‘Taxation and Human Capital’ (1996) 13 \textit{The American Journal of Tax Policy} 189.

\(^51\) \textit{Income Tax Assessment Act} 1915 (Cth) s14(h).

\(^52\) \textit{Income Tax Act} 1919 (Cth) s 7.
scale, thereby reducing the tax burden upon wealthier prize winners and increasing the tax burden on those with low incomes. Such a measure therefore clearly compromised the ideal of vertical equity embodied in the progressive system of tax rates. However, in speaking for the same Bill, the Treasurer rejected a proposal that corporate profits ought be taxed at a flat rate upon the basis that the concept of vertical equity was a keystone of the income tax system:

The proposal to tax a company's profits in the hands of the company would penalize shareholders with small incomes, and, at the same time, greatly benefit shareholders with large incomes by allowing them to escape tax by paying at greatly reduced rates through the companies.53

Aside from this ambivalence with respect to the discourse of tax fairness, it is also apparent that the legislature often compromised the fairness ideal for other policy reasons, including the imperative of framing an administrable tax and the perceived need to enhance the revenue. The taxation of foreign shipping companies according to a fixed percentage of their gross revenue,54 the exclusion of foreign source income until the introduction of a raft of reforms in the late 1980's and early 1990's,55 the taxation of non residents carrying on business in Australia without regard to any tax burden imposed in their country of residence56 and the double taxation of corporate income over the period 1940-1987 all represented breaches of the fairness ideal but were justified on other policy grounds.

53 Commonwealth, Parliamentary Debates, House of Representatives, 1 May 1918, 4262-3 (Acting Prime Minister and Treasurer, Mr Watt).
54 Income Tax Assessment Act 1915 s 22; see: The Ocean Steamship Coy Ltd v FCT (1918) 25 CLR 412; Union Steamship Co of New Zealand Ltd v Federal Commissioner of Taxation (1924) 35 CLR 209.
55 See, for example, the controlled foreign company provisions contained in Income Tax Assessment Act 1936 (Cth) Part X.
56 Film producers and foreign insurers being rendered liable to income tax in 1930, Income Tax Assessment Act 1930 (Cth) ss 13-14.
(c) Raising Revenue

The income tax was introduced and survived in part because it was considered a relatively efficient means of raising substantial sums of revenue. The perceived need to raise revenue was therefore central to the structuring of the income tax, often to the detriment of other considerations.\(^{57}\) Thus the first two Royal Commissions into taxation regularly weighed the need to protect the revenue along with other considerations in assessing various proposals for tax law reform.\(^{58}\) With respect to the Spooner Committee on Taxation, the Treasurer had expressed his view that the Committee should restrict itself to recommendations which were revenue neutral.\(^{59}\) The terms of reference to the Ligertwood Committee also emphasised this imperative by requiring the Committee to cost its recommendations.\(^{60}\) Even in 1965 it was accepted that various measures which breached the ideal of tax fairness, such as aspects of corporate taxation, were necessary on the basis of the revenue derived.\(^{61}\) More recently, the current government’s business tax reform is being considered upon the basis that it must be revenue neutral.\(^{62}\)

But from the preceding discussion regarding the discourses of fostering private investment and tax fairness, it is also clear that the rhetoric of raising revenue has not been dominant in all instances.

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\(^{58}\) See, for example, Commonwealth, First Report of the Royal Commission on Taxation, above n 30, 8, 21, 29, 32, 35.

\(^{59}\) The letter is referred to in Commonwealth, Report on Taxation of Income of Companies - Private and Non-Private - and of Shareholders, Parl Paper No 143 (1952) 6.

\(^{60}\) Commonwealth, Report of the Commonwealth Committee on Taxation, Parl Paper No 100 (1961) ix.


(d) Limitations imposed by a Relatively Small Tax Administration and Demands for an Unobtrusive Tax Administration

A further consideration taken into account by those framing the income tax was the capacity of the tax administration to administer a tax which required direct assessment of large numbers of people in a wide range of circumstances. At the inception of the Commonwealth income tax there were signs of a developing welfare state, and the concomitant acceptance of a much larger role for the executive branch of government. However, by modern standards the executive branch of Australian government in the first decades of the twentieth century was relatively small. Further, under the prevailing theory of government the imposition of administrative tasks upon the general population was generally considered undesirable.63

In his Second Reading Speech introducing what was to become the Income Tax Assessment Act 1922, the Treasurer alluded to the compromises between administrative expedience and other ideals necessarily embodied in the legislation:

We have done a substantial amount towards giving greater equity, but we have not done a great deal towards giving greater simplification. The Commonwealth system of taxation is new; it has been built up with a very great and almost alarming regard for equity; but the trouble is that we cannot secure great equity and at the same time maintain great simplicity. The more we attempt to be just the more complicated the administrative machinery becomes.64

63 In part, this rejection of any form of self assessment may have been founded upon concerns that the taxpayers would confuse the disparate rules applicable under the Commonwealth and state income taxes. Uniformity of the Commonwealth and state income taxes was a topic of much concern in the first decades of the Commonwealth income tax. Only after two Royal Commission reports upon the harmonisation of the respective Acts of the Commonwealth and State parliaments was uniform income tax legislation introduced in 1936; Second Report of the Royal Commission on Taxation, above n 15, 67-123; Commonwealth, Second Report of the Royal Commission on Taxation, Command Paper 7 (1934) 50-64.
64 Commonwealth, Parliamentary Debates, House of Representatives, 2 October 1922, 2972 (Mr Bruce).
The early administration of the Commonwealth income tax was marked by a poorly resourced bureaucracy which could not hope to effectively administer an income tax which satisfied even the mainstream conceptions of tax equity. In 1922 the first Royal Commission report noted:

At the Commissioner's request, we inspected the offices occupied by the Deputy Federal Commissioner and his staff, both in Melbourne and Sydney, and could form no other opinion than that in each case the staff was working under extremely bad conditions, due chiefly to overcrowding. In our opinion, such conditions militate against efficiency.\(^{65}\)

Given that the income tax often incorporated complex measures designed to achieve some degree of equity,\(^ {66}\) and given that the lack of modern data processing technology meant that the 300,000 taxpayers had to be individually assessed\(^ {67}\) in the absence of a self assessment regime,\(^ {68}\) it is little wonder that a small tax bureaucracy housed in inadequate office accommodation represented a considerable constraint upon the formulation of the income tax base in the early decades of the tax.

The significance of practical limitations upon the substantive provisions of the income tax may be gleaned from the first Royal Commission into the operation of the income tax, convened in 1921. For the purposes of the Royal Commission, the criteria applied in assessing various options for reform of the income tax system were founded upon the 'principles of taxation' formulated by


\(^{66}\) The difficulties of administering the requirement that companies distribute a 'sufficient' proportion of their profits are considered in the First Royal Commission: Commonwealth, *Second Report of the Royal Commission on Taxation*, above n 15, 80-8.

\(^{67}\) In the 1950's the Taxation Office began implementing 'comptor' technology as a means of coping with the increasing administrative workload prompted by population growth, economic growth, and the additional tasks assigned to it by the legislature; Commonwealth, *Fortieth Report of the Commissioner of Taxation*, Parl Paper No 31 (1961) 8.

\(^{68}\) Although the introduction of self assessment had been recommended in 1952, full self assessment was only introduced in the 1986/1987 year of income. See: Commonwealth, *Report on Self Assessment*, Parl Paper No 134 (1952).
Adam Smith: equity, administrative expedience, certainty, that the tax be levied at a time convenient to the taxpayer and the impact upon the revenue of proposed measures. In many of the findings of the Royal Commission the capacity of the Commissioner of Taxation to administer proposed taxing measures was a crucial consideration in determining whether such measures ought be adopted. Thus, for example, the taxation of casual profits was excluded upon the basis that it would not be administratively practicable to enforce such that 'any revenue derived would be to a great extent a voluntary contribution from conscientious taxpayers', and also that the concomitant allowance of 'casual losses' would open the way to evasion and result in a net loss to the Revenue. Administrative expedience was also a significant factor in leading to the majority of the Commissioners concluding that the taxation of foreign source income ought not be implemented. In 1934, despite the expansion of the tax office establishment, the first report of the Second Royal Commission appointed to inquire into the operation of the income tax recommended reform of the taxation of corporate profits, principally for the reason that an administrable system of corporate taxation ought take priority over considerations of tax equity. Further, in the first years of the

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69 First Report of the Royal Commission on Taxation, above n 30, 7-8.
70 Ibid 8.
72 Ibid 117. It is ironic that the refusal to include the taxation of capital gains was founded, in part, upon the view that taxation upon such 'income' would be purely voluntary, when the absence of the taxation of capital gains from the income tax base subsequently made the payment of income tax voluntary for those in a position to adopt tax minimisation measures. Nevertheless, it would appear inaccurate to assert that the limitation of the income tax base to the judicial conception of income, with some relatively minor exceptions, was borne of ignorance of the wider conception of income. Such a limitation was a conscious decision of the legislature made, at least ostensibly, on the basis of the inability to implement a broad income tax base and also upon the basis that the inclusion of 'casual gains' in the tax base would also suggest that casual losses ought be taken into account. The net revenue gain was therefore considered to be slight, and only achieved by a substantial addition to administrative complexity; contra Richard Krever, 'Avoidance Evasion and Reform: Who Dismantled and Who's Rebuilding the Australian Income Tax System' (1987) 10 University of New South Wales Law Journal 215, 225.
Commonwealth income tax, the time period for the calculation of income was arbitrarily determined at one year, with tax payable at the appropriate rate of tax. In 1922 this system had been modified by an averaging system whereby taxpayers paid tax upon the net income of the preceding year, but at a rate determined having regard to the taxpayer's average income over a maximum of the preceding five years. 75 Although this measure was rationalised upon equity grounds, a more pragmatic view, which took account of the administrative costs of the averaging system, lead to a recommendation that it be restricted to primary producers. 76

Over more recent decades the expansion of the tax office establishment, computerised data management and the imposition of administrative tasks upon members of the public 77 have played a significant role in expanding the capacity of the tax administration to oversee the operation of a mass income tax system. Nevertheless, the inability of the tax administration to effectively implement many taxation measures means that legislated measures may be poorly enforced, 78 subject to concessionary exemptions aimed at overcoming such

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74 Note the 1934 Royal Commission First Report which rejected the existing system of dividend taxation which sought to allow shareholders to obtain the benefit of income streaming through the company - this necessitated complex administration in an era when technology was not adequate to the task of administering an equitable tax - as a result the Commission Report recommended that companies be taxed at a flat rate and that shareholders receiving dividends be taxed at their marginal rate, with allowance for a standard rebate; Commonwealth, *First Report of the Royal Commission on Taxation*, above n 42, 15.


77 See, for example, the PAYE (Pay As You Earn) provisions in the *Income Tax Assessment Act 1936* (Cth) Division 2, Part VI; the Prescribed Payment System contained in the *Income Tax Assessment Act 1936* (Cth) Division 3, Part VI and the dividend imputation system which imposes substantial administrative burdens upon corporate entities, found in *Income Tax Assessment Act 1936* (Cth) Part IIIAA.

78 There is substantial anecdotal evidence suggesting that at least some parts of the capital gains provisions are often quite innocently ignored by taxpayers; for example the provisions dealing with 'collectables' and non income producing real property such as holiday houses.

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administrative incapacity\textsuperscript{79} or simply not passed into law.\textsuperscript{80} In 1984 the then Commissioner of Taxation accepted that the capability of the tax administration to effectively administer proposed measures will perhaps always play a significant role in shaping the income tax base:

Even in the best times, tax administration is not a perfect art. The ideal, the desirable, may have to give way to what it is that is practicable. And the judgement about what is practicable must be made, in prevailing circumstances, on the basis of the always-limited resources (be they human, material or legal) that are available to deal with the whole range of matters demanding attention.\textsuperscript{81}

The size and powers of the tax administration therefore often figured prominently in the structuring of the Commonwealth income tax.

\textbf{C Ad Hoc Tax Policy and the Interpretive Approach of the Courts}

The preceding discussion suggests that, from the outset, the income tax was founded upon numerous ad hoc political compromises between these (and other) concepts of the ideal income tax.\textsuperscript{82} The legislation does not embody the coherent scheme of any one ideal conception of an income tax, but instead comprises a range of provisions which implicitly deny any coherent scheme or purpose underlying the legislation as a whole:

The opinion of informed witnesses is that the Act is too scientific, and that it strives to attain theoretical equity as between all classes of taxpayers and all individual taxpayers. That ideal is unattainable, and the attempt involves a sacrifice of simplicity and convenience out of all

\textsuperscript{79} Thus, for example, under the capital gains provisions there are exemptions for many personal use assets: \textit{Income Tax Assessment Act} 1997 (Cth) s118-10(3).
\textsuperscript{80} See: Simons, above n 35, ch 2 for a consideration of some problematical components of an 'ideal' income tax.
proportion to the value of the results achieved. There are of necessity many arbitrary elements in the taxation system. The rate of tax is arbitrary, the scale of progression is arbitrary, the exemptions and deductions are arbitrary, and it is idle to hope that a system based upon such a foundation can be theoretically consistent in all its parts.\(^{83}\)

For the purpose of illustrating the influence of the various discourses upon the income tax, they have been described as if they were discrete discourses adopted by particular groups within the community. However, this portrayal is somewhat artificial in that it ignores the fact that these discourses were the components of a tax reform debate which was but a part of a wider philosophical debate with respect to the extent to which the modern Australian state ought embrace political philosophies ranging from 'state socialism' to a 'laissez faire' or neoclassical economic agenda. To those who maintained that government ought merely enable a free enterprise economy to function by imposing a minimum of regulatory restraint in order to ensure that capitalists were justly rewarded for their efforts, an ideal tax system might comprise a 'simple' tax imposed at a flat rate which neglected 'complex' tax base broadening measures and excluded wealth redistribution. An alternative, neoclassical vision, broadly founded upon a similar concern to reward enterprise, might seek maximal economic efficiency by introducing a conceptually 'simple', broad based tax upon income with few exemptions and no tax expenditures. To either of these groups an income tax was not necessarily the tax of choice - a consumption tax perhaps being attractive for its perceived simplicity. For those more receptive to the expansion of the welfare

state, the redistribution of wealth by the introduction of a broadly based income tax founded upon some understanding of economic gain and the imposition of tax according to a progressive tax scale would perhaps be ideal, regardless of any administrative complexities which might arise in the implementation of such a tax. Accordingly, not only the selection of the income tax as an appropriate subject of taxation, but also the framing of the elements of the income tax, were the subject of considerable debate between what were ultimately alternative formulations of the state/society compact.

According to the prevailing understanding of statutory interpretation prior to 1980, the crystallisation of this legislative eclecticism in the form of the income tax legislation was of no consequence, because the primary focus of the courts was upon the literal, or acontextual, meaning of the statute. The legal formality of literalism insulated the courts from any political controversy regarding the framing of the income tax which might rage outside the portals of the courts.

For the purpose of assessing this depiction of legal formalism in the interpretation of the Commonwealth income tax it is not possible, within the constraints of this thesis, and nor is it necessary, to comprehensively review the vast number of judicial decisions regarding the tax. A case study of the interpretation of the sufficient distribution requirement imposed upon companies will adequately illustrate the judicial methodology applied in interpreting the income tax legislation.

The sufficient distribution requirement was imposed upon certain categories of companies, requiring them to distribute a minimum percentage of their distributable profits to their respective shareholders. In the event that a

discussion of the influence of a range of discourses upon the income tax systems of the world see: Leif Muten, On the Development of Income Taxation since World War I (1967) passim.
company failed to make a sufficient distribution of profits, the Commissioner was authorised to include a deemed distribution of profits in the assessable income of the shareholders of the company according to their respective shares in the company or, subsequently, the Commissioner was authorised to impose additional tax, payable by the company, upon the profits which ought to have been distributed.

The principal reason for selecting the judicial interpretation of the sufficient distribution requirement is that it played a central role in the taxation of corporate profits throughout the period 1915 to 1987. Over this period the taxation of corporate profits proved to be problematic for a number of theoretical and practical reasons which will be considered below. This debate upon the proper method of taxing corporate profits necessarily included a debate upon the role of the sufficient distribution requirement. Given this debate about the existence and proper scope of the requirement, a study of the judicial interpretation of the sufficient distribution requirement represents an ideal opportunity to examine the extent to which the purported adherence to the literal meaning of the legislation sheltered the courts from the political debate regarding the requirement. Another, more pragmatic, reason for selecting the sufficient distribution requirement for a case study is the fact that the requirement was the focus of considerable critical attention, reflected in the repeated legislative and judicial consideration given to its terms. As such, the sufficient distribution requirement offers a relatively large sample of case law spanning the entire period under review.

84 Income Tax Assessment Act 1936 (Cth), s 104(3).
85 This debate was only in a sense resolved when the sufficient distribution requirement was effectively repealed with the introduction of the dividend imputation system in 1987. However, the debate remains relevant to this day, as there are strong arguments for the reintroduction of the requirement whenever the rate of tax with respect to corporate profits is lower than the top personal marginal rate of tax: Commonwealth, above n 43, 234.
86 Indeed, in 1934 Mr Scullin quipped 'Our old friend section 21 has been discussed in every session since we have had an income tax': Commonwealth, Parliamentary Debates, House of Representatives, 13 July 1934, 550.
Corporate Taxation and the Sufficient Distribution Requirement

1 How Ought Companies be Taxed?

The contentious character of the sufficient distribution requirement, and indeed the contentious character of the taxation of companies under the income tax law, may be illustrated by briefly reviewing the debate concerning the most appropriate means of taxing corporate profits.87 Discussion of the most appropriate model of corporate taxation has produced a substantial body of literature, the debate focusing upon the extent to which the corporate form ought be ignored for the purposes of taxation.

One option is to treat the corporate entity as a taxable entity which is entirely independent of its shareholders. The consequence of this approach is that income tax upon corporate profits might be imposed twice - once in the hands of the company and secondly if the after tax profits are distributed to the shareholders in a taxable form (ie dividends which attract no tax rebate).88 This system of taxing corporate profits twice was introduced in Australia in 1940, and was only completely repealed with respect to resident shareholders upon the introduction of the dividend imputation system in 1987.89 Despite the protests

87 For official consideration of this matter see, for example, Commonwealth, Second Report of the Royal Commission on Taxation, above n 15, 80-8; Commonwealth, First Report of the Royal Commission on Taxation, above n 42, 7-18; Commonwealth, Report on Taxation of Income of Companies - Private and Non-Private - and of Shareholders, Parl Paper No 143 (1952); Commonwealth, above n 61, ch 17.
88 This has been considered by some commentators as a form of double taxation since before the introduction of the Commonwealth income tax; see: ERA Seligman, Essays in Taxation (5th ed, 1905) 256; H Gibbs, The Incidence of Income Tax on Wasting Securities (1904). As noted in the Asprey Committee Report, it is not so much the fact of double taxation which is inequitable, as the rates of tax imposed upon shareholders which may produce inequity here. As detailed in that report, in 1975 the double taxation of corporate profits operated to impose rates of tax higher than the applicable marginal rate of tax with respect to low income shareholders, while imposing rates of tax lower than the applicable marginal rate of tax with respect to high income earners - an inversion of the progressivity ideal: Commonwealth, above n 43, 226-7; see also: Parsons, above n 42.
89 The extent to which non resident shareholders avoid double taxation upon corporate profits depends upon the extent to which the tax system in their country of residence allows a credit for the tax paid by the company in Australia, and also upon the terms of any tax treaty between
expressed in a number of submissions regarding the perceived inequity of this system, the Spooner and Ligertwood Committees recommended that it be retained. Only in 1975 did the Asprey Committee report recommend to the contrary.

At what might be described as the opposite end of the corporate tax policy spectrum is a model which completely ignores the corporate form for tax purposes. This model 'looks through' the corporate entity and treats each shareholder as if they received their aliquot share of the corporate profits. One perceived problem with this approach is the very fact that it imputes income to the shareholder and imposes taxation regardless of whether the taxpayer has actually received the money from which the tax may be paid. This could be overcome by the company making a sufficient gross dividend distribution in

Australia and the foreign country. A worst case scenario would be the double taxation of corporate profits; once at the corporate level which would produce an imputation credit which, while not available to the non-resident shareholder, effectively exempts the dividend from dividend withholding tax to the extent to which it carries such a credit (see: Income Tax Assessment Act 1936 (Cth) s 128B(3)(ga)), and once upon distribution of the corporate profits to the shareholder under the foreign taxation system.

The Spooner Committee referred to a number of submissions made to it arguing that the double taxation of corporate profits was justifiable as a war measure, but not to be countenanced during peacetime. These submissions were rejected primarily on the basis that the removal of a rebate system produced simpler administration, such that the equity markets had factored the double taxation of corporate profits into share prices and that the removal of double taxation would therefore merely bring windfall gains to those who had acquired shares since 1940; Commonwealth, Report on Taxation of Income of Companies - Private and Non-Private - and of Shareholders, Parl Paper No 143 (1952) 7. The Ligertwood Committee endorsed the taxation of companies according to the classical system as this accorded with the separate entity status of the company under the Australian legal system; Commonwealth, Report of the Commonwealth Committee on Taxation, Parl Paper No 100 (1961) 1-2. In its submission to the Asprey Committee in 1975 Treasury defended the double taxation of corporate profits on the basis that a flat company tax rate would generate tax avoidance. For a discussion of the Treasury submission see: CAS, 'Revenue Note' (1975) 49 Australian Law Journal 244. Only with the Asprey Committee did the calls for relief of double taxation of corporate profits receive some official approval, although no legislative action was taken upon this matter for another 12 years.


Commonwealth, above n 43.
order to produce an acceptable return to the shareholder net of tax. Even if the corporate profits are not distributed to the shareholder, the share value should, at least theoretically, increase to reflect the increased value of the company arising from the retention of profits. The shareholder therefore might be perceived to have made a *realisable* gain from which the tax may be paid.\(^93\) However the imposition of tax liability prior to the crystallisation of the gain is generally contrary to other income tax provisions,\(^94\) and also encounters considerable administrative hurdles where the capital of a company comprises different classes of shares with differing rights to participation in profits.\(^95\) Further, ignoring the corporate entity for tax purposes could have a deleterious impact upon the revenue. As Australia is a capital importing country and foreign shareholders would escape some or all Australian income tax upon their dividends,\(^96\) corporate tax revenue would therefore decline.\(^97\)

Another option for the taxation of corporate profits is to seek some combination of the two corporate tax systems noted above, while as far as possible eliminating the respective disadvantages of those options. The current dividend imputation system is one such model which imposes tax at the corporate level while allowing resident shareholders a credit for the tax paid by the company.\(^{98}\) The imputation system therefore adopts the first model by generally imposing

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\(^93\) Although this may be problematic in the case of shares which are less liquid, such as shares in some closely held companies.

\(^94\) Note the report of the Taxation Review Committee, above, n 92. However it should also be noted that the accruals basis of taxing particular amounts has been adopted in particular contexts: interest income for financiers is treated upon an accruals basis (*Alliance Holdings v FCT* 81 ATC 4637; *FCT v Australian Guarantee Corporation Ltd* 84 ATC 4642. Under some provisions of the income tax legislation an accruals basis of accounting is also adopted. See, for example, *Income Tax Assessment Act 1936* Div 16E.

\(^95\) Commonwealth, above n 43, 228.

\(^96\) Assuming that the dividend withholding tax rate is less than the personal tax rates imposed with respect to the income of residents, which it generally will be if the non-resident resides in a country with which Australia has entered into a double tax treaty. For further discussion of the taxation of non residents with respect to dividend income see: Geoffrey Lehmann and Cynthia Coleman, *Taxation Law in Australia* (1998) 1118-19.

tax at both the corporate and shareholder levels, but also seeks the perceived equity of the second model by effectively only imposing tax once upon corporate profits. 99

The competing models of corporate taxation therefore give differing weights to the discourses influencing the framing of the income tax. The first model might be more easily administered but rates poorly from the perspective of equity. The second model may be fairer, but may be more difficult to administer and may also cause a loss of revenue for capital importing countries such as Australia. 100 The third model is more complex to administer than the other models, achieves greater equity than the first model, is less than ideally equitable and the revenue implications are difficult to assess, although it was commonly acknowledged that there would be a decline in corporate tax revenue. 101

2 The Taxation of Corporate Profits under the Commonwealth Income Tax

The Income Tax Assessment Act 1915 (Cth) to some extent ignored the corporate form for the purposes of taxing corporate profits by allowing a deduction for any distributions to shareholders qua shareholders, but at the same time recognised the existence of the corporate form with respect to any

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98 Income Tax Assessment Act 1936 (Cth) Part IIIAA.
99 But note that the imputation system may operate disadvantageously for some shareholders such as non residents who may receive no tax credit under their domestic tax system for the Australian tax imposed at the corporate level, and who also lose much of the benefit of the imputation credit as it only entitles them to an exemption from the dividend withholding tax which is imposed at the rate of 10% as opposed to the corporate tax rate of 36%. Further, those who would not otherwise pay tax (for example, natural persons with an income below the applicable tax free threshold) are also susceptible to this wastage of imputation credits.
100 It is consistent with the argument developed in chapter six that the rational resolution of such conflicts is not possible, as it is not possible for unanimity to be reached upon the standpoint from which conflicting theories of corporate taxation may be assessed.
undistributed profits by taxing those profits at a relatively low rate. Given the absence of any rebate for the tax paid by the company upon undistributed profits, such profits might have been subject to double taxation when distributed to shareholders had it not been for a concessional practice by the Commissioner. In 1918 the legislature shifted towards a full integration model, under which companies were allowed a deduction for dividends paid, while with respect to undistributed profits taxed in the company’s hands, a rebate of tax equal to the lesser of the respective shareholder’s marginal rate of tax on the dividends or the rate of tax paid by the company on the shareholder’s share of the profits was allowed to the shareholder. However, this full integration system proved to be unworkable, given the relatively limited resources of the tax administration. From 1 July 1922 a revised system was introduced whereby companies were taxed at a low rate upon all of their profits, and shareholders were assessed upon their dividend income at their marginal rate of tax subject to a rebate for the company tax already paid. The quantum of the rebate was the lesser of the shareholder’s proportionate share of the amount of tax paid by the company, determined according to the shareholders proportionate share in the capital of the company, or the proportion of the shareholder’s tax liability with respect to income from property determined by establishing the ratio of dividend income to income from property overall.

102 Income Tax Assessment Act 1915 (Cth) s 14; Income Tax Act 1915 (Cth) s 4(3). This retention allowance was varied over time, until it was ultimately set at a level which did not achieve equity between private companies and other tax entities (Commonwealth, Reform of the Australian Taxation System -Draft White Paper, above n 61, para 17.5).
103 Parsons, above n 42, 18.
104 Income Tax Assessment Act 1918 (Cth) s 16 (2A). Note that only shareholders whose total incomes exceeded the taxable threshold were eligible for this rebate. The inequity of this system was noted in: Commonwealth, Second Report of the Royal Commission on Taxation, above n 15, 86.
106 Income Tax Assessment Act 1923 (Cth) s 6(a) repealed the deduction with respect to dividends paid by a company.
107 Income Tax Assessment Act 1922 (Cth) s 20(4). As the corporate tax rate had fluctuated over the life of the income tax, the calculation of the company tax paid upon the profits from which
This system also proved unworkable and was modified in the new uniform legislation of 1936 by allowing the shareholder a rebate which was the lesser of his or her marginal tax rate or the rate of tax paid by the company. \(^{108}\) However, in 1940 this rebate was repealed, \(^{109}\) and until 1987 corporate profits were generally subject to tax at both the corporate and the shareholder levels. \(^{110}\)

The taxation of corporate income under the Commonwealth income tax therefore by no means reflected the dogmatic application of one theory of corporate taxation. Initially, there was an accommodation of the two competing theories of corporate taxation - the corporate form was both ignored and recognised in certain circumstances. Even with the shift to the 'classical' system of corporate taxation after 1940, elements of the integrated approach to corporate taxation remained, for example in the form of the intercorporate dividend rebate and the allowance of a deduction to a company for tax paid upon corporate profits. The important point for present purposes is that the taxation of corporate profits under the Commonwealth income tax was neither framed in terms of the consistent application of one principle, nor was it capable of being framed according to one principle which held universal support. \(^{111}\)

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the dividend was sourced was often a major undertaking. This attempt at an equitable treatment of corporate profits ran aground upon the shoal of administrative difficulties. The failure of the Commissioner to recalculate tax rebates after adjusting the assessments of corporate taxpayers was the subject of some criticism: Commonwealth, *First Report of the Royal Commission on Taxation*, above n 42, 11-15. To overcome this problem the Royal Commission recommended that the rebate be allowed either at a fixed rate or at the shareholder's marginal rate of tax; ibid, 15.

\(^{108}\) *Income Tax Assessment Act 1936* (Cth) s 46.

\(^{109}\) *Income Tax Assessment Act 1940* (No 2) (Cth) s 4.

\(^{110}\) Except with respect to intercorporate dividend payments made to a public company, which continued to attract a tax rebate, the effect of which was that the first company was generally ignored for tax purposes; *Income Tax Assessment Act 1936* (Cth) s 46. In 1987 the dividend imputation system was introduced, *Income Tax Assessment Act 1936* (Cth) Part IIIAA.

3 The Sufficient Distribution Requirement

Throughout all of the legislative changes to the taxation of corporate profits it was advantageous to shareholders with high incomes to have corporate profits retained by the company, and therefore subjected to a lower rate of tax in the hands of the company only.\(^\text{112}\) Initially this advantage existed because the undistributed profits of the company were taxed at a rate which was lower than the marginal rate of tax upon income from property paid by a high income shareholder.\(^\text{113}\) This differential between the rate of tax upon corporate profits and the rate of tax upon personal income persisted in varying degrees until the introduction of the dividend imputation system in 1987.\(^\text{114}\) But a much more significant reason for the retention of profits within the corporate form arose after the restriction of the shareholder dividend rebate to intercorporate dividend payments in 1940,\(^\text{115}\) as after that amendment the same corporate profits would be taxed twice if distributed to natural persons in the form of dividends. After 1940 then, the effective rate of tax upon corporate profits distributed to shareholders could be much higher than the personal marginal rate of tax.

\(^{112}\) Of course, companies pay tax at a flat rate with no tax free threshold, as opposed to the progressive tax rate scale applicable to individuals. However, at the margin it would be advantageous to high income taxpayers if profits could be sheltered in the company and thereby subjected to the lower, corporate tax rate. This perceived shortcoming was acknowledged in the First Royal Commission; Commonwealth, Second Report of the Royal Commission on Taxation, above n 15, 85. In his evidence before the Royal Commission, the Commissioner of Taxation stated that in the 1919-20 income year 225,364 shareholders with dividend income either paid no tax because their total income was less than the taxable threshold, or paid tax at a marginal rate lower than the applicable corporate tax rate. The number of shareholders with income tax rates in excess of the corporate tax rate, the Commissioner stated, was 2,636; Commonwealth, Second Report of the Royal Commission on Taxation, above n 15, 82.

\(^{113}\) In an attempt to maintain neutrality between partnerships and companies, the legislature briefly allowed a rebate of tax to partnerships and sole traders upon a portion of their profits; see: Income Tax Assessment Act 1922 (Cth) s 30. However, this provision required the Commissioner to exercise a discretion in determining that the partnership or sole trader carried on a business in which it was necessary to retain some portion of profits for capital investment, a discretion which the Commissioner only rarely exercised; Commonwealth of Australia, Tenth Annual Report of the Commissioner of Taxation, Parl Paper 96 (1927) 16-17. This provision was repealed in 1934. For discussion of this measure see Parsons, above n 42, 19-20.

\(^{114}\) Income Tax Assessment Act 1936 Part IIIAA.

\(^{115}\) Income Tax Assessment Act 1940 (No 2) (Cth) s 54.
imposed with respect to other sources of income, depending upon the marginal rate of tax paid by the individual shareholder.

In the absence of any mechanism to control such behaviour, the possible retention of corporate profits within the corporate form would have presented a tax minimisation opportunity to those taxpayers who were paying tax at higher marginal rates. To many, to allow such tax minimisation was contrary to the ideal of tax fairness, according to which individuals ought pay tax according to their means. Of course, one means of preventing such taxpayers from exploiting this opportunity would have been to require companies to distribute all of their profits to their shareholders. However, while recognising the importance of such tax equity considerations, successive governments also heeded the discourse of private investment. This discourse maintained that the retention of corporate profits was an important means of fostering business investment in a developing nation. Even in the face of mounting evidence of tax minimisation by the retention of corporate profits, one Prime Minister rejected what he considered to be overly strict controls upon the exploitation of this tax minimisation opportunity, because of the perceived benefit to the nation flowing from the investment of capital:

> The harm to the community would be greater than the advantage gained from catching a few persons who were endeavouring to avoid their taxation obligations. In a country such as Australia, our one aim should be to build up industries and to encourage those who are controlling industry through the agency of a joint-stock company not to distribute too great a part of their profits, but, on the contrary, to retain as much as possible for the expansion and stabilization of their business.

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116 For discussion of the planning opportunities available with respect to private companies see NHB, ‘Taxation of Private Companies’ (1947) 21 Australian Law Journal 46.
117 See, for example, Commonwealth, First Report of the Royal Commission on Taxation, above n 42, 28-9; Commonwealth, Report on Taxation of Income of Companies, Parl paper No 143 (1952) 1.
118 Commonwealth, Parliamentary Debates, House of Representatives, 30 September 1924, 4894 (Mr Bruce, Prime Minister).
Of course, another response to the question of the retention of corporate profits and the perceived loss of revenue and inequity was to follow this business investment rhetoric to its ultimate conclusion, and allow companies to retain all of their profits at their absolute discretion. However, the countervailing force of the tax equity discourse weighed against this course of action. In the end, the legislature adopted a compromise between the competing discourses of equity, administrative expediency and the imperatives of capital accumulation. This compromise was embodied within a sufficient distribution requirement.

4 The Manifestation of Competing Discourses in the Sufficient Distribution Requirement

Under the first version of the sufficient distribution requirement, companies were obliged to distribute what the Commissioner considered to be a reasonable proportion of their distributable profits. Companies were therefore authorised to retain a reasonable proportion of their profits for reinvestment, and so shelter that portion of their profits from what would often be the higher marginal rates of tax that applied at the shareholder level. If a company overstepped the authorised level of profit retention, the Commissioner made a notional distribution of profits to the shareholders and assessed them accordingly, and also imposed tax upon the company with respect to all of the undistributed profits. Subsequently, this broad administrative discretion was limited when Parliament established a numerical threshold by requiring companies to

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119 Although the legislation originally applied to all companies, it seems that it was administratively impossible, or undesirable, to apply the sufficient distribution requirement to public companies. In his Twenty-Third Report the Commissioner of Taxation noted that '[a]s a matter of practice, the additional tax on undistributed income for all years 1915-16 to 1933-1934 was not assessed in the case of large public companies. It was uneconomic, administratively, to do so.' Commonwealth, Twenty-Third Report of the Commissioner of Taxation, Parl Paper No 94 (1943) 23.

120 The result was that the sufficient distribution requirement effectively imposed double taxation. For a discussion of this and the amending legislation overturning such double taxation, see: Commonwealth, Parliamentary Debates, House of Representatives, 1 May 1918, 4256 (Mr
distribute at least two thirds of their profits or face the prospect of showing the Commissioner good cause for retaining more than a third of their profits.\textsuperscript{121} If a company did not distribute the minimum percentage of profits, and the Commissioner was not satisfied as to the legitimate need for the company to retain those additional profits, the Commissioner could calculate the personal income tax that would have been paid by the shareholders had the profits been distributed, and impose additional tax upon the company.\textsuperscript{122} If the improperly retained profits were subsequently distributed to the shareholders, each shareholder was entitled to a rebate for the tax paid on undistributed profits at the corporate level.\textsuperscript{123}

Prior to 1934 the sufficient distribution requirement had been framed in such a way that it appeared to apply to both public and private companies,\textsuperscript{124} but the scale of the administrative task in applying the requirement to public companies meant that it was never applied to public companies.\textsuperscript{125} The Royal Commission

\textsuperscript{121} Income Tax Assessment Act 1922 (Cth) s 21. For criticism of the former position, and the recommendation that a provision in the nature of s 21 be adopted, see: Commonwealth, Second Report of the Royal Commission on Taxation, above n 15, 88.

\textsuperscript{122} Income Tax Assessment Act 1922 (Cth) s 21.

\textsuperscript{123} Income Tax Assessment Act 1922 (Cth) s 20(4). This produced an anomalous result. It was accepted practice in Australia that a company would distribute the gross dividend without reduction for any tax payable. When the company paid a dividend out of profits which had been subjected to the retained profits tax, the shareholder received the gross dividend and the tax rebate, the loss being borne either by the holders of other classes of shares or being deferred until a later year. For discussion of this point see: Commonwealth, Second Report of the Royal Commission on Taxation above n 15, 86-7. A further anomaly was that while the company paid the tax which would have been paid by the shareholders as a whole, the tax payable by wealthier shareholders upon the notional dividend distribution was effectively subsidised by those with lower incomes: Commonwealth, First Report of the Royal Commission into Taxation, above n 42, 35.

\textsuperscript{124} Income Tax Assessment Act 1922 (Cth) s 21 was expressed to apply to 'a company'.

\textsuperscript{125} The effective exclusion of public companies had been officially noted; Commonwealth, Eleventh Annual Report of the Commissioner of Taxation (1928) 15; Commonwealth, First Report of the Royal Commission into Taxation, above n 42, 30. Other reasons for the exclusion of public companies from the requirement were the belief that little or no additional tax would
into Taxation therefore recommended that the terms of the sufficient distribution requirement be restricted to private companies, a recommendation that was adopted by the legislature. However, with the outbreak of the Second World War, Parliament once again imposed the sufficient distribution requirement upon public companies, albeit in a separate Part of the ITAA. In 1951 this requirement was repealed, but the sufficient distribution requirement with respect to private companies was retained.

The restriction of the sufficient distribution requirement to private companies was apparently justified upon the basis that it was closely held companies which would exploit the lower corporate tax rates by retaining an excessive portion of their respective profits. This assumption was founded upon the belief that closely held companies were in a better position to cater for the specific needs of a limited number of shareholders, whereas public companies would generally be more likely to distribute a considerable portion of their profits in order to maintain shareholder support. However, bearing in mind that the rationale of the sufficient distribution requirement was to overcome the perceived inequity of the preferred model of corporate taxation, the restriction of the sufficient distribution requirement to 'private' companies, as defined, was rather clumsy. Many large private companies managing substantial asset portfolios would have legitimate reasons for retaining profits, but could only do so knowing that such restrictions would be raised by the application of the sufficient distribution requirement to public companies (ibid, 30), and also the administrative difficulties experienced in applying the requirement to public companies; Commonwealth, Parliamentary Debates, House of Representatives, 5 July 1934, 276 (Mr Casey).

127 Income Tax Assessment Act 1940 (Cth), s 11 which inserted Part IIIA into the Income Tax Assessment Act 1936 (Cth); this Part effectively imposed additional tax on 75% of the undistributed profits of public companies.
128 Income Tax and Social Services Contribution Assessment Act 1951 (Cth) s 24.
retention was susceptible to attack by the Commissioner. Furthermore, it is possible that some public companies would foster shareholder support by retaining profits and thereby enhancing the capital value of shares which could be sold tax free by many shareholders.

Once the decision had been made to tax actual distributions of profits and restrict the ability of companies to retain profits to those with 'legitimate' reasons for doing so, it became necessary to differentiate between a retention of profits for tax minimisation purposes and a retention of profits for legitimate purposes. The only means of effectively monitoring this differential treatment of corporate profits would have been to conduct detailed investigations into the financial position of each corporate taxpayer retaining profits - a task beyond the capabilities of the tax administration system. It was therefore necessary to exclude a large range of companies by reference to 'objective' criteria, the existence of which could be ascertained upon a brief examination of the circumstances of each corporate entity. Such objective criteria were always going to appear imperfect and arbitrary when compared with the detailed investigation into the taxpayer's subjective purpose required for perfect implementation of the conception of tax equity. As such, the identification of the rationale behind these objective criteria was problematic because they embodied a Delphic attempt to reconcile the competing ends of administrative expediency, equity and commercial practicality.

The identification of the legislative intention with respect to the sufficient distribution requirement was also complicated by the interaction of the

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130 True, such large private companies could rearrange their structures in order to become 'public' companies, but there might well be commercial reasons for not wishing to do so, such as the desire to retain control within a small group of shareholders.

131 It was accepted that some public companies adopted this course; Commonwealth, First Report of the Royal Commission into Taxation, above n 42, 30; Commonwealth, above n 43, 244. The capitalisation of profits was most advantageous given the absence of any effective taxation of capital gains, only introduced with effect from 20 September 1985; Income Tax Assessment Act 1936 (Cth) Part IIIA, now Income Tax Assessment Act 1997 (Cth) Part 3-1.
sufficient distribution requirement with the corporate tax provisions. It has been suggested that the obligation to distribute corporate profits was rationalised upon fairness grounds, while the provision for a retention allowance was justified by the perceived need to foster corporate investment. However, these respective principles were apparently contradicted by the combined operation of the sufficient distribution requirement and the double taxation of corporate profits. If it is accepted that the discourse of tax equity suggests that corporate profits ought only be taxed once, the imposition of double taxation upon corporate profits was clearly inequitable. By compelling a distribution of corporate profits in the context of a tax system which imposed taxation at both corporate and shareholder levels, the sufficient distribution requirement was the mechanism by which shareholders were forced to pay tax upon company profits at rates which were often higher than the shareholder's personal marginal rate of tax. Had the double taxation of corporate profits and the escalation of corporate tax rates after 1940 been complemented by the repeal of the sufficient distribution requirement, some semblance of tax fairness might have remained while the promotion of corporate investment might have been enhanced by creating a shelter from double taxation. But by introducing double taxation of corporate profits, raising corporate tax rates and retaining the sufficient distribution requirement, the Parliament had created a system of corporate taxation which was inexplicable from the perspectives of equity or promoting corporate investment, and could only be rationalised as a penal revenue measure which singled out corporate profits. As if in recognition of the perceived inequity of such double taxation, but whilst refusing to adopt a system of taxation whereby corporate profits were taxed just once, the retention

132 See above, p 184.
133 Although note that the sufficient distribution requirement was restricted to private companies after 1951; see n 128 above.
134 This was the view adopted by the Royal Commission in 1933; Commonwealth, First Report of the Royal Commission on Taxation, above n 42, 11.
allowance was varied - at times apparently with the object of ameliorating the impact of the sufficient distribution requirement upon private companies. 135

The sufficient distribution requirement was therefore framed in response to several often competing discourses upon what the income tax should and could achieve. The sufficient distribution provisions initially reflected a legislative attempt to reconcile the discourses of equity and private investment, but as the inability of the tax administration to cope with a corporate tax system which met these ideals became apparent, the legislation was amended to the point that it proved inexplicable upon either of these grounds. The differentiation between public and private companies for the purposes of the requirement, while compelled by the inability of the tax administration to cope with a broadly framed requirement, only heightened the apparently arbitrary operation of the requirement.

But whether the sufficient distribution requirement was framed upon an arbitrary reconciliation of the competing discourses influencing taxation policy, and whether the purpose of the provisions was clear, were questions which were irrelevant to the judicial interpretation of the provisions if the interpretative methodology was such that the courts objectively determined the literal meaning of the statutory words. If the courts merely applied the acontextual meaning of the statutory words regardless of any political storms that might rage outside the portals of the courts, the consequences of any judicial decision were a political problem and not a legal one. At this point it is therefore appropriate to examine whether or not the interpretative methodology adopted by the Australian courts

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135 The percentage allowed to be retained varied over time, during the early phase it was 33%, while during the 1950's and 1960's it ranged up to 50%. In more recent times it was reduced and different categories of income were treated differently. Under the most recent legislation, the most income that could be retained was 80% of the personal exertion income component of 'reduced distributable income' and 10% of the property income component of the reduced distributable income; Income Tax Assessment Act 1936 (Cth) s 105B(1).
was consistent with the depiction of literalism commonly accepted in the historical account of tax interpretation.

**E The Early Judicial Decisions - A Literalist or an Intentionalist Rhetoric?**

In deciding the first case with respect to the sufficient distribution requirement, the High Court apparently rejected any contemplation of legislative purpose in favour of the rhetoric of literalism.\(^{136}\) In that case the relevant company's profit and loss account showed a profit of £12,663 for the 1917-1918 year. After taking into account various tax accounting items, the assessable income of the company was considered by the Commissioner to total £15,007. For that year no dividend was paid by the company. The Commissioner therefore decided that the relevant company had not satisfied the sufficient distribution requirement, and sought to impose tax upon £12,663 of the undistributed profits in accordance with s 16(2). Section 16(2) provided that:

> Where, in the opinion of the Commissioner, a company has not in any year distributed to its members or shareholders a reasonable proportion of its taxable income, the taxable income of the company shall be deemed to have been distributed to the members or shareholders in proportion to their interests in the paid up capital of the company, if the Commissioner is satisfied that the total tax payable on it as distributed income is greater than the tax payable on it by the company.

The Commissioner issued an assessment to the taxpayer upon the basis of the notional distribution of £4,534, being the taxpayer's share of the corporate profits. The taxpayer objected to the assessment principally upon constitutional grounds, but one aspect of his case raised a perceived difficulty with the operation of s 16(2). The taxpayer argued that the taxable income of the company was not determined until the end of the relevant year, and submitted that it was impossible for the company to make any distribution of its taxable

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\(^{136}\) *Cornell v Deputy Federal Commissioner of Taxation* (1920) 29 CLR 39.

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income until after the end of the relevant year. Accordingly, the taxpayer submitted that s 16(2) was inoperative. The taxpayer also argued that the assessment was invalid in that the Commissioner had only made a notional distribution of a portion of the taxable income, rather than the entire taxable income.

The High Court adopted the rhetoric of literalism in considering the operation of s 16(2):

On this question it is unnecessary to say more than that in our opinion it is clear on the words of the sub-section construed literally that, when the Commissioner is of opinion that less than a fair proportion of the profits have been distributed, the whole amount of profit which would otherwise have been taxable income of the company is to be deemed to have been distributed to the shareholders.\textsuperscript{137}

The Court therefore upheld the Commissioner's assessment, accepting that it was within the Commissioner's discretion to assess the taxpayer upon the assumption that the company had distributed less than its taxable income. But while the High Court used the rhetoric of literalism, it is doubtful whether there was necessarily only one literal meaning of the provision in the manner that the High Court suggested. Section 16(2) operated in conjunction with s 16(1), which provided that:

For the purpose of ascertaining the taxable income of a company there shall be deducted from the total assessable income, in addition to any other deductions allowed by this Act, so much of the assessable income as is available for distribution and is distributed to the members or shareholders of the company.

On one interpretation of the provision, the taxable income of the company was therefore the amount remaining \textit{after} any distribution of profits to members and/or shareholders. On this view, s 16(2) required companies to distribute a
'reasonable proportion' of any 'taxable income', which by definition was assessable income less all allowable deductions including the deduction allowed under s 16(1). This meant that a taxpayer could never make a 'reasonable distribution' out of its taxable income, because the distribution of profits was considered for the purposes of s 16(1) to be made out of gross income. The result would have been that the requirement to distribute a reasonable proportion of taxable income would have applied ad infinitum to the decreasing pool of profits which had not yet been distributed. On the basis that s 16(2) was presumably intended to apply to the company's taxable income before the deduction allowed under s 16(1), it is arguable that s 16(2) was nonsensical because it would apply to any company which failed to distribute 100% of its taxable income to its shareholders (a distribution which might have been in breach of the relevant Articles of Association, because taxable income could be greater than the accounting profits of the company).

On an alternative reading of s 16(2), by deeming a distribution to have been made, the legislature had not excluded the operation of s 16(1), which allowed a deduction for any distribution of profits to the shareholders. By not excluding the operation of s 16(1), s 16(2) therefore created a closed logical loop according to which s 16(2) could never apply because all companies which failed to distribute a reasonable proportion of their taxable income would be deemed to have distributed 'the taxable income' and therefore, by virtue of s 16(1), would have no taxable income. This shortcoming of s 16(2) was implicitly acknowledged and overcome by the Income Tax Assessment Act 1922 (Cth), in which s 21(4) defined 'taxable income' for the purposes of the new s 21 in terms which excluded the deduction of any deemed distribution of profits.

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137 Cornell, above n 136, 48.
A further difficulty with s 16(2) was that it deemed a distribution to have been made without specifying the time for such distribution. In the absence of a specified time for the deemed distribution, it would be impossible for the Commissioner to calculate the additional tax paid by the shareholders, as the identity and income of the shareholders could change over time.\footnote{Note that under a progressive tax rate system the amount of a shareholder's taxable income is crucial in determining the applicable marginal rate of tax.}

Although it purported to apply the literal meaning of the legislation, the High Court overcame these difficulties by treating s 16(2) on the footing that it applied to 'the profits'\footnote{Cornell, above n 136, 48.} of the company, as opposed to the company's taxable income. Whether or not it is accepted that a 'literal meaning' of 'taxable income' existed, the vast disparity between accounting profits and taxable income meant that, by the time of Cornell, it was at least recognised that taxable income was not necessarily synonymous with 'profits'.\footnote{For the purposes of the Act taxable income was defined as assessable income less allowable deductions, which begs the question as to the meaning of those terms. As may be seen from chapter 3, the meaning of 'income' was problematic long before the introduction of the Commonwealth income tax.} The High Court decision may be understood as any of a misconceived application of the law, an application of what was perceived to be the legislative purpose or an act of judicial lawmaking. This decision could not have been an application of the 'literal meaning' of the legislation in the sense of an understanding of the statutory terms founded upon acontextual meanings not reasonably open to dispute - the recognised difference of 'profits' from 'taxable income' belied the semblance of literalism endorsed by the High Court in this case.

Despite the literalist rhetoric adopted by the High Court in Cornell, in other early cases the courts were more prepared to expressly consider matters of policy in interpreting the sufficient distribution requirement. One example of this approach may be seen in the Supreme Court decision of Kellow-Falkiner
In *Kellow-Falkiner* the issue was the time by which a company was required to make a distribution of profits in order to comply with the sufficient distribution requirement. Section 21 of the ITAA merely referred to this issue in passing, stating that ‘where, in any year a company has not distributed to its members or shareholders at least two-thirds of its taxable income’ the Commissioner was authorised to make a notional distribution of profits unless special circumstances existed. The phrase ‘in any year’ had several possible meanings in this context. It might have meant the financial year (ie 1 July to 30 June) in which the profits were derived or the year immediately following upon the year in which the profits were derived.

From a practical perspective, allowing companies to make a distribution within a reasonable time after the year in which the profits were derived had some merit. Companies would rarely be in a position to determine their profits for a relevant accounting period prior to the termination of that period, simply because of the practical difficulty of accurately determining profits before the end of the financial period. Of course, one option was for companies to adopt a conservative approach to tax compliance by making a substantial distribution in anticipation of their profits before year end, thereby ensuring that they exceeded the two-thirds threshold of s 21. But to suggest that companies ought err on the side of compliance by retaining less than one third of their profits would seem contrary to the policy underlying the retention allowance and the imperative of determinate law.

Once again from a practical perspective, there was also merit in taking the view that s 21 required a distribution within the company’s income year. This was because many companies had obtained approval from the Commissioner to adopt a substituted accounting period under s 32(3) of the Act, whereby their tax return was prepared for a different period to the usual 1 July to 30 June financial
year. In such cases, if the year referred to in s 21 was the financial year rather
than the company's income year, the application of the sufficient distribution
requirement to such companies would require the Commissioner to construct an
account of a company's profits for the financial year in order to determine
whether a sufficient distribution of those profits had been made. Given the
Commissioner's limited resources, such a time consuming undertaking was out
of the question and the sufficient distribution requirement would therefore
effectively be inapplicable with respect to those companies with substituted
accounting periods.

The third possible interpretation was that s 21 required a distribution of profits
within the income or financial year of derivation, as opposed to allowing a
reasonable time after the expiration of such period for the making of
distributions. This interpretation could be rationalised on the grounds that the
purpose of s 21 was to ensure that the corporate form was transparent for tax
purposes, aside from the express provision for the retention allowance.142
According to this view, shareholders ought be taxed upon their share of
corporate profits in the year that those profits were derived by the company,
rather than obtaining a tax deferral (and hence the time value of the additional
tax liability) merely by virtue of the fact that their income was derived in a
corporate form.

Whether or not the words 'in any year' had an acontextual, literal meaning at the
time of Kellow-Falkiner, it is apparent that in the context of the ITAA there
were several inconsistent, yet seemingly plausible, interpretations of the phrase
which produced widely differing results for the parties to the dispute. However,
in this case Lowe J clearly opted for the rhetoric of a purposive construction of
the legislation in appraising the merits of the competing interpretations. His

142 For discussion of the possible purposes of the sufficient distribution requirement see:
Parsons, above n 42.
Honour concluded that the purpose of the provision was to achieve an equitable tax system:

Sections 16(b), 20 and 21 are a group of sections which deal with the taxable income of a company and bring it within the net of taxation, whether in the hands of shareholders or of the company. To effect this result it seems to me to be necessary that the same period should be contemplated, and it seems reasonably clear, under secs.16(b) and 20, that it is the year of the earning of the income that is referred to. 143

With respect to companies with substituted accounting periods, Lowe J held that the substituted period did not apply for the purposes of s 21. As a result of this decision, it was virtually impossible for the Commissioner to apply s 21. Further, this interpretation of the provision presented considerable problems to the business community, which confronted a provision with which it would be exceptionally difficult to comply whilst simultaneously retaining the full benefit of the retention allowance.

Although Lowe J cast his decision in terms of a purposive construction, it is difficult to understand how an interpretation which satisfied one perception of tax equity, but was administratively unworkable, was necessarily within the legislative intention. Indeed, the proposition that the legislature intended to achieve tax equity by requiring a distribution of corporate profits within the year of derivation necessitated a considerable leap of faith, given the apparent inequity of some aspects of the income tax legislation and the fact that the sufficient distribution requirement itself reflected the influence of several competing discourses. In this context it has already been noted that the identification of any one predominant purpose is implausible. Further, even if the imperative of tax equity was recognised as predominant in the context of the sufficient distribution requirement, it is difficult to see how this imperative was met by the construction of s 21 in Kellow-Falkiner. By championing tax equity,

143 Kellow Falkiner v Federal Commissioner of Taxation, above n 141, 280.
Lowe J adopted an interpretation of the requirement which made it inoperative in a substantial number of cases. How this self-contradiction could be considered to be the necessary outcome of a purposive construction of the sufficient distribution requirement was not considered by Lowe J. Indeed, within weeks of the decision in *Kellow-Falkiner*, the Commonwealth government introduced amending legislation with the object of remediying the perceived shortcomings of the Act arising out of this decision.144

The revised s 21 was reconsidered by the High Court in *Neal's Motors Pty Ltd v Federal Commissioner of Taxation*.145 In that case the Commissioner had determined that 10 July 1930 was the relevant date for distribution of corporate profits for the year ending 30 June 1929. The taxpayer company had not distributed any of its profits for that income year by the date specified. The Commissioner therefore made a determination that £32,397 could reasonably have been distributed to the shareholders. Accordingly, he calculated the respective shareholder’s additional income tax liability (which was payable by the company in accordance with the terms of section 21) by including their respective portions of that sum in their income for the 1929-1930 income year. The taxpayer company disputed this additional liability on the basis that the Commissioner had selected the wrong income year for ascertaining the shareholders’ additional liability. The taxpayer argued that as the distribution could have been made after the end of the 1929-1930 financial year, the

144 The *Kellow-Falkiner* decision was handed down on 8 August 1928, the *Income Tax Assessment Bill* 1928 was introduced into Parliament on 11 September 1928; Commonwealth, Parliamentary Debates, House of Representatives, 11 September 1928, 6569 (Dr Earle Page, Treasurer). In the Committee stage of consideration of the Bill in the House of Representatives the Attorney-General, Mr Latham, noted that ‘the court [in *Kellow-Falkiner*] has held that the Commissioner must apply his mind only to such distribution of income as could reasonably have been made in the twelve months in which the profits have been derived. This again is an entirely new point. There is no meritorious substance in it at all. It arises out of the technical wording of the section. If now an alteration were made in the law, a large number of assessments would be declared to be invalid. The object of the first sub-clause now before the committee is to put this matter right’; Commonwealth, *Parliamentary Debates*, House of Representatives, 18 September 1928, 6807 (Mr Latham, Attorney-General).
145 (1932) 48 CLR 233.
calculation of tax liability should have been made on the assumption that the profits had been distributed in the 1930-1931 year. If this approach had been adopted, the Commissioner would have had to wait until the end of the 1930-1931 financial year in order to determine each shareholder’s taxable income and the appropriate amount of tax that would be payable upon the notional distribution of profits. As was the case in Kellow-Falkiner, the advantage to the taxpayer company under its interpretation of s 21 was a deferral of tax liability (the time value of money), an outcome contrary to the discourse of tax equity which would suggest that the notional distribution ought be assumed to have been made in the year that the profits were derived by the company.

Perhaps with the legislative response to the decision of Lowe J in Kellow-Falkiner in mind, and perhaps in recognition of the difficulty of ascertaining the legislative intention, the majority of the High Court eschewed a ‘purposive’ rhetoric in favour of a close reading of the legislative text, and therefore purported to adopt a literalist methodology. In doing so, Dixon J (in the majority) acknowledged that the history of the provision was relevant, but stopped short of a discussion of the purpose of the provision. The reasoning of the majority justices was based upon the proposition that there must be a temporal link between the deadline for sufficient distributions determined by the Commissioner under s 21(1), and the time at which the Commissioner ascertained the liability of the respective shareholders in companies which had failed to meet that deadline. The majority accordingly held that the Commissioner ought determine the additional tax liability based upon the assumption that the notional distribution of profits to shareholders took place in the year after the profits were derived by the company. The reasoning of Dixon J for this conclusion was perhaps the most forthright:

146 Ibid 247.
Once the conclusion is reached that the reasonable capacity of the company to distribute is to be determined in reference to a period expiring on the fixed day, it seems an inevitable consequence that, in the complete absence of any indication of any other date as at which the distribution should be supposed, the latest date must be taken of the period within which a distribution might reasonably have been made.147

Why this was the ‘inevitable’ meaning of the provision is not clear. As Dixon J observed, the case concerned an apparent lacuna in the legislation which could only be resolved by adopting the ‘better’ interpretation of s 21 overall, rather than the identification of the one acontextual meaning of the legislation. Certainly, the interpretation ultimately adopted by the majority of the High Court was plausible in that it was founded upon a justifiable assumption that the date of the deadline could be taken as identical to the date of the notional distribution. But there were other plausible interpretations founded, for example, upon the discourse of tax equity, which would suggest that the better interpretation required that the notional distribution ought be assumed to have been made in the same year as the year in which the profits were derived by the particular company.148 On this reading, s 21 would have allowed a company to distribute a percentage of its taxable income after the expiration of the year of derivation, but in accordance with the discourse of tax equity identified by Lowe J in Kellow-Falkiner and Starke J in his minority judgment in Neal’s Motors, the time of this notional distribution might have been deemed to fall within the year of derivation. It is therefore arguable that the foundation of Dixon J’s judgment is not necessarily as secure as he suggested, in that there was not necessarily a ‘complete absence of any indication of’ the timing of the notional distribution.

147 Ibid 248 (Dixon J).
148 On the basis that the taxation of companies and partnerships was intended to be treated in a similar fashion: see: above n 113.
distribution. The appearance of literalism therefore belied the existence of ‘hard’ judicial discretion in this case.¹⁴⁹

The significance of *Cornell*, *Kellow-Falkiner* and *Neals Motors* is that they neatly illustrate the ease with which the courts moved between a literalist rhetoric and a purposive rhetoric at a time in which, by many accounts, the courts uniformly adopted a literalist or strict construction of tax legislation. Further, the cases also illustrate the argument that the courts were confronted with competing interpretations of the tax legislation arising out of standpoints founded upon the rhetorical discourses woven into the legislative framework. Notwithstanding the objectivist rhetoric adopted by the courts in these cases, there was no one ‘right’ or ‘obvious’ interpretation discovered by the courts. A plausible interpretation of these cases suggests that, in the absence of any rational path to reconciling such conflicting standpoints, the courts exercised a hard discretion in selecting one interpretation.

**F The Differentiation of Public and Private Companies and Judicial Pragmatism**

The restriction of the sufficient distribution requirement to private companies, and the theoretical difficulties that this posed, have already been noted.¹⁵⁰ Clearly, public companies were in a privileged position in comparison to private companies. By differentiating between private and public companies, the legislature created a window of opportunity for small companies clothed in

¹⁴⁹ In 1934 the Royal Commission on Taxation reported that, as a result of *Neal’s Motors*, the Commissioner was only able to issue assessments for additional tax payable under s 21 some two years after the close of the relevant accounting period; Commonwealth, *First Report of the Royal Commission into Taxation*, above n 42, 36. The Royal Commission therefore recommended that the *Income Tax Assessment Act* be amended to provide that any notional distribution to shareholders pursuant to s 21 be deemed to occur at the end of the relevant accounting period; ibid. This recommendation was adopted by the Parliament by the *Income Tax Assessment Act 1934* (Cth) s 13. The wheel had therefore turned a full circle, and the decision of Lowe J in *Kellow-Falkiner* was embodied in the legislation.
public garb to exclude themselves from the sufficient distribution requirement. The definition of ‘private company’ was therefore drafted in light of the multifarious schemes created by taxpayers for the purpose of escaping the sufficient distribution requirement.\textsuperscript{151} The new §31A accordingly incorporated a number of sub-sections deeming a company to be a private company in a range of circumstances.\textsuperscript{152} Notably, the legislation looked to the control of the relevant company, whether by reference to the shareholding of the relevant person or otherwise.\textsuperscript{153} Curiously, though, one of the provisions of the United Kingdom income tax legislation upon which the Australian provisions were modelled had already been criticised as ‘unintelligible and ridiculous’ before the introduction of the Australian legislation,\textsuperscript{154} a fact which did not escape the attention of the High Court.\textsuperscript{155} The difficulty which had been identified with the United Kingdom legislation was that it was expressed in such broad terms that, when one interpretation of the provision was applied to particular circumstances, it could produce ridiculous results.\textsuperscript{156}

\textsuperscript{150} See discussion above under the heading ‘The Manifestation of Competing Discourses in the Sufficient Distribution Requirement’.
\textsuperscript{151} Commonwealth, Third Report of the Royal Commission on Taxation, above n 76, 112-121.
\textsuperscript{153} Thus, for example, Income Tax Assessment Act 1934 (Cth) §31A(2)(c) provided that ‘a company shall be deemed to be under the control of any persons where the major portion of the voting power or the majority of the shares is held by those persons or is held by those persons and nominees of those persons or where the control is, by any other means whatever, in the hands of those persons’.
\textsuperscript{154} Himley Estates Ltd v Commissioner of Inland Revenue (1933) 1 KB 472, 486 (Lawrence LJ), 487 (Romer LJ).
\textsuperscript{155} Adelaide Motors Ltd v Federal Commissioner of Taxation (1942) 66 CLR 436, 444 (Latham CJ), 449 (Rich J) and 450 (Starke J).
\textsuperscript{156} Himley Estates, above n 154, 487 (Romer LJ).
In *Adelaide Motors Ltd v Federal Commissioner of Taxation* the taxpayer company had issued 41,700 fully paid shares and 20,000 preference shares. The company was listed on the Adelaide Stock Exchange, there being thirty ordinary shareholders and sixty-eight preference shareholders. Of the shareholders, the three directors and their associates controlled 61% of the ordinary shares and a majority of the shares overall. In applying the sufficient distribution provisions in this case, the Commissioner relied upon s 103(1), which defined a private company as 'a company which is under the control of not more than seven persons, and which is not a company in which the public are substantially interested or a subsidiary of a public company'. A company in which the 'public was substantially interested' was also a defined term, essentially being a company in which at least 25% of the voting shares were held by 'the public' and which were quoted on the Stock Exchange. For the purposes of applying this definition of 'private company' in the present case, the Commissioner selected the three directors and four otherwise unrelated shareholders, who between them controlled 36,850 ordinary shares (representing approximately 88% of the ordinary shares). The Commissioner did not claim that all seven of the selected shareholders actually controlled the relevant company in the sense that they wielded their voting power in a bloc, or participated in the day to day management of the company, but argued that as there were just seven shareholders who between them controlled more than 75% of the ordinary shares, both elements of the definition of 'private company' were satisfied.

In the leading judgment of the High Court, Latham CJ noted that there were 9,086 possible combinations of the thirty shareholders which could be considered to hold a controlling interest in the company. Having accepted that the first limb of the definition of a private company was satisfied, Latham CJ therefore turned to the second limb of the definition, and in particular the meaning of the reference to 'the public'. Noting that in one sense everybody is

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157 Above n 155.
a member of the public, Latham CJ observed that s 103 assumed that at least some shareholders were not members of the public for the purposes of the section. In yet another significant departure from any purported application of the literal rule of interpretation, his Honour continued by considering the perceived purpose of Division 7, suggesting that its object was to treat certain closely held companies as if they were a partnership:

Certain shareholders may correspond to partners, the others being “outsiders” - and therefore members of the public. But in a case such as the present, where it is not shown that the artificially created “control group” is actually a controlling group, it is not easy to apply the rough general conception upon which the statutory provisions are based. 158

His Honour observed that if the Commissioner’s approach was adopted, it would be tantamount to accepting that the definition of a private company might have been expressed in an alternative fashion, by merely stating that a private company is a company in which no more than seven shareholders control more than 75% of the voting shares of the company. Discounting this approach, Latham CJ observed that:

It would have been easy for the legislature to make such a provision if this is what was intended, as the Commissioner contends. But Parliament has not made this simple provision. On the contrary, it has deliberately introduced a reference to the holding of shares by the public. The Court should not ignore this feature of the legislation. 159

His Honour therefore noted that it was necessary to determine whether there was any characteristic shared by the four shareholders who were not directors which differentiated them from ‘the public’, such as the fact that they shared in the actual control of the company. Finding that no such characteristic existed, he

158 Ibid 446; for a discussion of the original policy considerations supporting the restriction of the sufficient distribution requirement to private companies, see: First Report of the Royal Commission on Taxation, above n 42, 30.
159 Adelaide Motors, above n 155, 447.
held that the company did not fall within the definition of a private company for the purposes of s 103.

Rich and Starke JJ decided against the Commissioner, but on grounds which were at least in part different to those underlying the judgment of Latham CJ. In particular, Rich and Starke JJ considered that the first element of the definition of a private company (ie control of the company vested in less than eight persons) was not satisfied. Starke J gave the clearer exposition of the reasoning underlying this conclusion:

In terms the section only refers to a company which is under the control of not more than seven persons; it contemplates and provides for a single group of not more than seven persons of whom it can be established that they, and no other, control the company. Those persons may control the company because they have the major portion of the voting power, the majority of the shares may be held by them or their nominees, or the control is by any other means whatever in their hands. The section becomes unintelligible if, according to the Act, the control of the company may be deemed to be in any of a number of groups of shareholders not exceeding seven persons, and as in this case, in several thousands of such groups. 160

The High Court therefore took the view that Division 7 was only intended to apply to those closely held companies which were actually controlled by no more than seven shareholders who held more than 75% of the voting shares in the company. Both of these judgments seem to have expressly or implicitly relied upon the proposition that the legislature intended the sufficient distribution provisions to apply only to those companies in which actual control of corporate affairs could be identified in the hands of a small group, on the basis that such companies could be equated with a small partnership. Latham CJ expressly referred to this proposition while Starke J's reference to the control of the company being in the hands of the identified control group, and no other, would seem to have been similarly founded.
Why this restriction upon the sufficient distribution requirement ought, of necessity, have been imputed to Parliament is not apparent from the judgments. It is difficult to identify anything in the legislation to this effect. Certainly, in 1940 the legislature had effectively abolished the retention allowance by requiring private companies to distribute 100% of their net profits each year, and so private companies were in some respects being treated in the same way as partnerships. But it was also clear that private companies were not being treated in the same way as partnerships under the income tax legislation. The double taxation of corporate profits, the imposition of company tax without the benefit of a tax free threshold and the imposition of tax upon dividends at the higher rate applicable to income from property were in stark contrast to the imposition of tax upon a partner’s share of partnership profits in the hands of the respective partner only.\textsuperscript{161} Indeed, there was no avenue by which the High Court could achieve equal treatment of corporate and partnership profits for tax purposes in this case. If the application of the sufficient distribution requirement was upheld, the corporate profits were subject to double taxation. On the other hand, if the application of the sufficient distribution requirement was rejected, the corporate profits would be subject to tax at the flat corporate rate applicable to private companies without regard to the personal marginal rates of tax applicable to each shareholder (whereas partners would pay tax at their personal marginal rate of tax upon their share of partnership profits).

The proposition that the legislature intended that closely held companies should be treated in the same fashion as partnerships is therefore open to question. Once the disparity of treatment under the income tax legislation of closely held companies and partnerships is acknowledged, much of the force of the view that

\textsuperscript{160} Ibid 450-1.
\textsuperscript{161} For discussion of the differential treatment of private companies and partnerships see: Commonwealth, First Report of the Royal Commission into Taxation, above n 42, 31.
the references to 'private companies' in Division 7 were intended to mean small
'incorporated partnerships' loses its force. Further, given that small
partnerships and 'private companies' for the purposes of Division 7 may be
quite dissimilar, there is additional justification for questioning whether the
purpose of Division 7 was as clear cut as Latham CJ seemed to suggest.

One alternative construction of s 103 might have held that it applied to a much
broader range of companies, because the definition of a 'private company'
included all of those companies in which less than eight shareholders controlled
more than 75% of the voting shares in the company. According to this view, it
was irrelevant whether or not the definition of 'private company' was satisfied
in cases where the company was not actually controlled by the seven nominated
shareholders. As noted above, Latham CJ implicitly acknowledged that this
interpretation was open on the terms of s 103, before dismissing it on the basis
that it overreached the perceived legislative intention. However, it was not
necessarily the case that this broad operation of s 103 overreached the legislative
intention. Even if it had been conceded that in some way the sufficient
distribution requirement was intended to effect a degree of tax neutrality
between partnerships and private companies, the argument might continue, it
was not clear that this purpose ought prevail over other purposes of the rule. If
an alternative purpose of Division 7 had been given a higher priority than the
purpose emphasised by the High Court, such as the prevention of closely held
companies being used for the purposes of tax minimisation, it might have been
accepted that the broader interpretation of s 103 was quite consistent with 'the'
legislative purpose. The broader interpretation of s 103 would quite possibly
have included many companies which were not being used for the purposes of
tax minimisation, and so it might seem inequitable that they would have been
required to distribute all of their profits in the context of the double taxation of
corporate profits. However, it might have been accepted that another purpose of
the provision was to produce an administratively workable rule, as to assume that the legislature intends to produce an unworkable rule seems nonsensical. To achieve this purpose the legislature often identifies 'objective' criteria, such as the measurable control interests in a company, as an administratively practicable means of delimiting the operation of a provision. Such 'objective' criteria are much more readily applied to the circumstances of particular taxpayers than a test which requires a finding that a group of taxpayers actually control a company. At times such criteria may seem to apply in a manner contrary to one perceived purpose of a legislative provision or to one conception of tax equity. The desire to minimise such apparent overreaching of a rule must therefore be weighed against the imperative of identifying an administratively workable rule. Thus if it was accepted that the legislature intended to restrict the retention of corporate profits on the basis that such conduct is inequitable, and if the legislature was taken to have intended to produce a rule which achieved this objective despite some perceived collateral inequity, s 103 could quite validly have been interpreted to apply to all of those cases in which less than eight shareholders controlled more than 75% of the shares.

The prevailing account of tax interpretation suggests that the literal approach was the basis for reading down the income tax legislation. However, if the rhetoric of the High Court in Adelaide Motors is taken at face value, it is clear that a purposive rhetoric was applied in concluding that the sufficient distribution requirement was not applicable in that case. Further, even if the purposive interpretation adopted by the High Court is considered to be

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162 Of course, it is possible that an unworkable rule is introduced as a face saving measure - a means of indicating that something is being done about an issue when in fact nothing will change. But to suggest that such rules are a common feature of legislative activity is perhaps to adopt an unduly cynical theory of legislation.

plausible, it is arguable that there was another plausible interpretation founded upon a differing standpoint of tax equity and administrative expediency.

The *Adelaide Motors* and *West Australian Tanners* decisions provoked a repeal of s 103 in 1948 and its replacement with a modified definitional provision.\(^{164}\) The definition of a private company was expanded and renumbered as s 103A in 1951.\(^{165}\) The new definitional provision defined a private company by stating several tests, only one of which needed to be satisfied. The new tests included ‘objective’ criteria, such as the voting power of the company being controlled by a limited number of persons (whether or not the identified persons actually exercised such control), and also a broad de facto control provision. The time for the application of these tests was 30 June of the relevant income year. Despite this reworking of the provision, it became clear that taxpayers were still manipulating their circumstances with the object of ensuring that Division 7 did not apply, so that they were able to retain profits within a company in excess of the amount allowed under Division 7, and not be subject to additional tax upon the undistributed profits.

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164 It had also been noted that ‘[d]uring recent years a number of companies, have been able to establish public company status, and thereby secure the advantage of being taxed on undistributed profits at the lower rate applying under the Income Tax Act for public companies. In addition, it has been brought to the notice of the Committee that, with the introduction of a lower primary rate for company taxable incomes up to £5,000, and the establishing of minimum permitted retentions out of the undistributed incomes of private companies, a number of private companies are subdividing their operations and conducting them by several companies, each of which obtains the advantage of these concessions intended only for one taxing concern’; Commonwealth, *Report on Taxation of Income of Companies - Private and Non-Private - and of Shareholders*, Parl Paper No 143 (1952) 5. The Committee also noted that ‘[t]he Committee has had placed before it many methods by which companies, in essence private companies, have succeeded in placing themselves outside the present definition of “private company”’; ibid 9. See also the Second Reading speech to the *Income Tax Assessment Bill 194*; Commonwealth, *Parliamentary Debates*, House of Representatives, 8 September 1948, 271 (Mr Dedman, Minister for Defence, Minister for Post-War Reconstruction and Minister in charge of the Council for Scientific and Industrial Research).

165 *Income Tax and Social Services Contribution Assessment Act 1951* (Cth) s 15.
The first case dealing with the revised legislation, and in many respects the most significant, was *W.P. Keighery Pty Ltd v Federal Commissioner of Taxation*.\(^{166}\)

In that case the taxpayer was incorporated on 20 June 1952. Mr Keighery and his wife were the only two subscribers to the memorandum, taking four ordinary shares between them. The two shareholders appointed themselves directors. On 27 June 1952 an extraordinary general meeting was held at which it was resolved to issue one redeemable preference share to twenty persons respectively, the redeemable preference shareholders being friends of the Keighery's and also staff members of the Keighery's accountant. According to the special resolution, the directors could redeem any of these redeemable preference shares at any time, provided that: no redemptions could occur between 24 June and 7 July in any year; at least seven days notice of any intended redemption had been given; the redemption payment was made out of profits of the company; and that the company had complied with various restraints imposed under the relevant companies legislation. According to the company's Articles of Association, an extraordinary general meeting could only be held after 21 days notice, but the Keighery's had the ability to redeem the preference shares after just 7 days notice. Thus, if notice of a general meeting of the company was given on 30 June, there was a strong likelihood that the Keighery's could control the composition of the shareholders and thereby control the company in general meeting.

The Commissioner treated the company as a private company for the purposes of Division 7 and accordingly assessed it to additional tax upon its undistributed profits. This categorisation of the taxpayer as a private company was founded upon the de facto control provision in s 105(1)(f) of the *Income Tax Assessment Act 1936*, which provided that a company was a private company if it was 'capable of being controlled by any means whatever by one person or by persons not more than seven in number.' The Commissioner relied upon two notions of

\(^{166}\) (1957) 100 CLR 66.
control. The first concept of control focused upon the fact that the Keighery's could wield the threat of redeeming a recalcitrant shareholder's preference share in order to ensure that that shareholder would vote 'appropriately' at any general meeting. The second concept of control focused upon the fact that, even if the Keighery's did not exercise the first form of control, they were nevertheless capable, as at 30 June 1952, of obtaining control of the company in general meeting by virtue of their ability to redeem the preference shares after notice of the meeting had been given but before the meeting was held.

In the High Court a majority comprising Dixon CJ, Kitto, Taylor and McTiernan JJ upheld the taxpayer's appeal. Dealing with the Commissioner's first argument, the joint judgment of Dixon CJ, Kitto and Taylor JJ held that:

It is of course, nothing to the point that the existence of the power of future redemption might conceivably have made the holders of the redeemable preference shares more willing than otherwise they would have been to comply with the wishes of Mr. and Mrs. Keighery. Clearly enough, the description of a company as "capable of being controlled" is not satisfied by the mere fact that a majority of shareholders, while not under any legal or equitable obligation to obey the directions of other persons, may possibly prove so anxious to retain shares which those other persons are able to eliminate that they will obey those directions against their own desires. A power in a person to provide shareholders with an incentive or inducement to exercise their voting power as that person may wish is not aptly described as making the company capable of being controlled by that person. The person must be able to dictate the decisions of the general meeting, through a preponderance of voting power which either is vested in him or is subject to his command.167

The joint judgment therefore adopted what was taken to be the 'technical' meaning of control, being the ability to carry a resolution at general meeting.168

One alternative interpretation, which might be characterised as the 'practical'169

167 Ibid 85.
168 Ibid 84.
169 FCT v Sidney Williams (Holdings) Ltd (1957) 100 CLR 95, 115 (Webb J).
understanding of s 105(1)(f), was summarily dismissed in the companion case to Keighery:

But to give effect to this argument would be to construe the expression “capable of being controlled” as referring, not to a capability existing in law - that is to say a liability to a lawful control by the exercise of legal or equitable rights or powers which persons are shown to possess.\textsuperscript{170}

Whilst it must be conceded that the formalistic adherence to the technical meaning of control was a plausible interpretation of s 105(1), it is not necessarily the case that this was the only plausible interpretation of the provision. Although the High Court denied the relevance of the practical meaning of s 105(1)(f) with considerable rhetorical force, neither of the decisions in Keighery nor Sidney Williams offered any reasons for this conclusion and, indeed, omitted to expressly address arguments for such alternative interpretations.

For example, the High Court ignored the (rebuttable) presumption that statutory words are intended to have some effect which, it will be recalled, Latham CJ referred to in his decision in Adelaide Motors. By interpreting s 105(1)(f) in terms of actual control of the company general meeting, the High Court rendered s 105(1)(f) coextensive with s 105(1)(b) which provided that a company which fell outside the exclusionary limbs of s 105(1) would be a private company if it was ‘a company in which more than half of the voting power is capable ... of being exercised by one person or by persons not more than seven in number’. According to the High Court, there was only one means that control could be exercised - by voting at general meeting. But the reference to ‘any means whatsoever’ in s 105(1)(f) suggested that the control might be exercised in a number of ways, all of which were intended to be caught by the revised provision. By interpreting control in a one dimensional way, the High Court

\textsuperscript{170} Ibid 112 (Dixon CJ, Kitto and Taylor JJ).
Court effectively ignored the statutory words 'any means whatsoever', and in doing so seemingly contradicted the rhetoric adopted by Latham CJ in *Adelaide Motors* that the legislative words must be assumed to have some operation. The legislative reference to 'any means whatsoever' could quite plausibly have constituted the foundation of an interpretation of s 105(1) which accepted that a private company included those companies which could potentially be controlled by a small group of shareholders by mechanisms such as those created for the Keigherys. Although the High Court dismissed the practical meaning of control with a conviction which makes the judgment rhetorically appealing, this certainty as to the meaning of control belies the existence of choices open to the court in applying s 105(1)(f).

Further, even if a 'practical' test had been adopted, it is clear that the High Court would have imposed a stringent requirement for the test to be satisfied, nothing less than an absolute ability of the nominated shareholders to control the general meeting being considered sufficient for the purposes of the hypothetical 'practical' test. In this regard, it was noted by their Honours in the joint judgment that there were contingencies surrounding the ability of the Keighery's to redeem the preference shares which mitigated against any conclusion as to their ability to exercise practical control of the company. For example, it was noted that the directors might die before the general meeting, or that the company might not have sufficient profits to redeem the shares in accordance with the Articles of Association:

Even if they continued to be the directors, there was no certainty, however great the probability may have seemed, that at the expiration of the period specified in the requisite notice the company would still be in a position to satisfy the conditions laid down by s.149 of the Companies Act... Mr and Mrs Keighery therefore had no absolute power to eliminate the votes of the preference shareholders. The company was capable of being made controllable by them in certain eventualities; but
that is not to say, that the company was then capable of being controlled by them.\(^{171}\)

Had a practical test of control been adopted, the joint judgment concluded, some hypothetical ability of the Keighery’s to remove the other shareholders at some time after 30 June 1952 was considered to be irrelevant in applying the definition of a private company. ‘Capability’ was therefore treated as synonymous with certainty, a conclusion which is evident from the extract from the judgment dealing with this matter. But ‘capable’ need not necessarily have been interpreted in this way. For example, ‘capable’ could have been interpreted to include a reasonable likelihood that the nominated shareholders would control a general meeting at some future time. Had this construction been adopted, the contingencies identified by the High Court could have been dismissed as too improbable to justify the conclusion that the Keigherys were not in a position to control the company at a hypothetical general meeting: the requirement as to redemption of the shares from profits could have been satisfied by making an appropriate cash gift to the company to put it into a profit position and the technical requirements of s 149 could not really be considered to represent any significant barrier to redemption of any shares. The possibility of the death of the Keighery’s must also be conceded but may be discounted on grounds of remoteness.

With respect to the second contention on behalf of the Commissioner, the issue was whether ‘capability of control’ extended to the possibility of control being obtained at some future time, or whether the phrase ought be restricted to the existence of a formal ability to control the company in general meeting as at 30 June. The joint judgment opted for the latter approach upon the basis that ‘the natural sense of the expression is that of possessing, as a present attribute, a liability to be controlled.’ This conclusion was stated with a similar certitude later in the judgment:

\(^{171}\) Keighery, above n 166, 89.
The truth is that “capable of being controlled” connotes the existence of either one person whose enforceable and immediately exercisable rights enable him to control, or a number of persons whose enforceable and immediately exercisable rights enable them, if they act in concert, to control. 172

On the basis that the legislative purpose of s 105(1)(f) was to respond to the decision in Adelaide Motors by extending the definition of a private company to cases where no more than seven persons were in a position of controlling a company, the justices in their joint judgment noted that their interpretation of s 105(1)(f) would apply to the facts of Adelaide Motors. Therefore, they maintained, their interpretation of the provision was in accordance with the legislative purpose. Given that on 30 June 1952 there were 22 shareholders with one vote each (Mr Keighery with three votes), the majority of the High Court considered that no grouping of seven shareholders could possibly control the company at general meeting if a meeting had been held at that time. The High Court also referred to what it considered to be the legislative purpose of s 105(1), which was stated to be the broadening of the category of private companies from those actually controlled by a small number of shareholders to include those companies which could be controlled by a small number of shareholders. This discussion of the legislative purpose was curiously bereft of any consideration of the wider purpose of the sufficient distribution requirement - a discussion of which might (but need not necessarily) have lead the High Court to the view that a broader scope for s 105(1) was appropriate. Had the High Court considered the wider purpose of the sufficient distribution requirement, as it had done in Adelaide Motors, the court might have constructed an interpretation more favourable to the Commissioner on the basis of the rhetoric of tax equity and the perceived purpose of restricting the use of companies for tax minimisation purposes. On this basis it might have been

172 Ibid 87.
concluded that s 105(1) meant that the Keigherys' company was a private company and therefore fell within the sufficient distribution requirement.

The decision in *Keighery* therefore construed s 105(1) to mean that a company was a private company only if less than eight shareholders held the legal ability to control the company in either an actual or hypothetical general meeting on 30 June in any year. This interpretation was founded upon what was described as the 'technical legal' meaning of control and the 'natural' meaning of 'capable of being controlled'. Whereas previous decisions such as *Adelaide Motors* had restricted the operation of the sufficient distribution requirement by relying upon the rhetoric of a purposive construction, in this case the High Court expressly relied upon both literalist and purposive rhetorics in limiting the operation of the provision.

At the same time as the decision of *Keighery*, the High Court adopted a similar approach to a different scheme, with the same purpose of circumventing Division 7 of the Act, in the decision of *Federal Commissioner of Taxation v Sidney Williams (Holdings) Limited*. Compounding the loss of revenue arising from these decisions, no legislative action in response to these decisions was taken for almost seven years after they were handed down, despite the concerns expressed by the 1961 Ligertwood Committee on Taxation at the loss of revenue suffered as a result of such arrangements. In this seven year period the legislative delay, in the context of the frequent amendments to

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173 Above n 169.
174 Minor amendments were made to s 105B by the *Income Tax and Social Services Contribution Assessment Act (No 2) 1959* (Cth) s 10 and s 105AA (a procedural provision) was inserted by the *Income Tax and Social Services Contribution Assessment Act (No 2) 1963* (Cth) s 39.
175 The decisions in *Keighery* and *Sidney Williams* were both handed down on 19 December 1957; the *Income Tax and Social Services Contribution Assessment Bill (No 3) 1964*, in which the provisions relating to private companies were substantially rewritten, was introduced into Parliament on 22 October 1964; Commonwealth, *Parliamentary Debates*, House of Representatives, 22 October 1964, 2219 (Harold Holt, Treasurer).
the sufficient distribution requirement since the inception of the Commonwealth income tax in 1915, might perhaps justifiably have been perceived as no less than legislative sanction of the decisions of the High Court. Further, the legislative delay constituted tacit acceptance of the rhetoric of the need to foster capital investment by ameliorating the impact of the double taxation of corporate profits (at least in the case of private companies), by enabling corporators to shelter income from taxation within the corporate form. 177

When they were finally introduced in 1964, the amendments to the sufficient distribution provisions adopted a fresh approach to the distinction between private and public companies. Instead of defining private companies, and stating that all other companies were public companies, the new provision adopted the opposite approach by defining public companies and providing that all other companies were private companies. Safeguard provisions, whereby companies which otherwise satisfied the definition of a public company but were so closely held as to warrant being deemed to be private companies, were included to deal with circumstances such as the facts of Adelaide Motors. Significantly, subsidiaries of public companies were generally deemed to be public companies, and the safeguard provisions mentioned above did not apply to such subsidiaries.

While these amendments overcame the specific minimisation arrangements considered in Keighery and Sidney Williams, there were opportunities to exploit the exclusion of subsidiaries of public companies by issuing the requisite amount of shares to a public company while, in many respects akin to Keighery and Sidney Williams, ensuring that those shares were subject to the ultimate control of the real controllers of the subsidiary. Indeed, the possibility of such arrangements was reasonably clear in the light of decisions of the High Court

177 It is significant that at this time the legislature was encouraging the retention of profits within the corporate form by allowing a relatively high retention allowance of up to 50%.
handed down before the introduction of the 1964 amendments. Of course, such arrangements required the complicity of a public company, but to taxpayers prepared to enter into such arrangements, the identification of such public companies was achievable. That such arrangements were available to well-advised taxpayers shortly after the 1964 amendments is evident from the case of Federal Commissioner of Taxation v Casuarina Pty Ltd. In Casuarina a taxpayer and his wife controlled private companies which had derived substantial profits. If the portion of those profits above the permitted retention allowance was not distributed, it would have been subject to the undistributed profits tax under Division 7. To escape Division 7, the taxpayer entered into an arrangement developed by a firm of accountants for the purpose of circumventing the Division. The taxpayer’s accountants had incorporated a company (Forum Holdings Ltd (‘Forum’)), the majority of the shares being beneficially held by at least two public companies. As a result, Forum was a public company for the purposes of Division 7. The taxpayer and his wife acquired all of the 49 ordinary shares in a shelf company (Casuarina Pty Ltd (‘Casuarina’)), and 51 redeemable preference shares were issued by Casuarina to Forum. These redeemable preference shares were issued under conditions similar to those outlined in Keighery. That is, the redeemable shares could not be redeemed between 24 June and 7 July in any year. Again in a manner similar to the facts of Keighery, as a result of the conditions upon the calling of general meetings established in the Articles of Association of Casuarina, the preference shareholders were the de jure controllers of the company but, in practice, the taxpayer and his wife could reasonably be expected to control the company at

178 Adelaide Stevedoring Co Ltd v Federal Commissioner of Taxation (1963) 109 CLR 309, where it was held that the relevant definition of a subsidiary of a public company focused upon formal control irrespective of who actually exercised control over the subsidiary. This decision, when combined with the opportunities for manipulation of share rights along Keighery and Sidney Williams lines, opened the door for tax minimisation arrangements using public company subsidiaries.
any general meeting of which notice was given on 30 June in any year. In fact, Forum played no role in any decision made by Casuarina, being content to receive its small dividend from the preference shares each year.

Similar arguments to those raised in *Keighery* were raised by the Commissioner in this case, as the issues were whether Forum, by virtue of its preference shareholding, was the majority shareholder in Casuarina and also whether it held the preponderance of voting rights.\(^{180}\) As the arrangements had been entered into with the intention of ensuring that these requirements were satisfied, and given the factual similarity in many respects to the matters which were considered in *Keighery*, all members of the High Court held that the taxpayer had succeeded in cloaking Casuarina with public company status.

Both *Keighery* and *Casuarina* are striking for the clear purpose of the taxpayer in creating the circumstances to circumvent Division 7, and the High Court’s insistence that, as the taxpayer did not fall within the express terms of the relevant provisions, those provisions did not apply. Why the technical meaning


\(^{180}\) To establish the public company status of Casuarina, it was necessary to determine whether Casuarina was a subsidiary of a public company. A subsidiary of a public company was defined in s 103A(4) in the following terms: ‘[f]or the purposes of this section, a company is a subsidiary of a public company in relation to the year of income if, at the end of the year of income, one or more companies that are public companies for the purposes of sub-section (1) of this section in relation to the year of income but none of which is a company referred to in paragraph (c) of sub-section (2) of this section-

(a) beneficially owns or own shares representing more than one-half of the paid-up capital of the first-mentioned company;
(b) is or are, by reason of its or their beneficial ownership of shares in the first-mentioned company, capable of controlling or of obtaining control of more than one-half of the voting power in that company;
(c) would be beneficially entitled to receive more than one-half of any dividends paid by the first-mentioned company; and
(d) would be beneficially entitled to receive more than one-half of any distribution of capital of the first-mentioned company in the event of the winding up, or of a reduction in the capital, of that company.’
of control was the most appropriate interpretation of the relevant provision was not considered by the court. Once again, there were plausible alternative interpretations. For example, the High Court might have adopted the view that, if Division 7 was going to have some scope for operation, it ought to apply in the case of taxpayers who structure their affairs in order to escape the technical meaning of the Division. After all, to ignore the prospect of effective control of other shareholders was arguably contrary to an ‘ordinary’ understanding of the term ‘control’. Once again, then, the operation of Division 7 had been restricted by the exercise of ‘hard’ judicial discretion which was cloaked by a rhetoric of literalism.

One year later, the legislature moved to close the loophole exposed by Casuarina, principally by the means of vesting a discretion in the Commissioner to treat what would otherwise be a public company as a private company if, in his or her opinion, the subsidiary company was managed without proper regard to the interest of the relevant holding company.\(^\text{181}\) Thereafter a number of taxpayers sought to cloak their companies in public garb, but such attempts were repelled by the High Court.\(^\text{182}\) However by this stage tax minimisation advisers had moved on to greener pastures offered in the form of trust structures, which made a host of tax avoidance and evasion arrangements possible.\(^\text{183}\)

Furthermore, the retention allowance under the sufficient distribution

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\(^{181}\) *Income Tax Assessment Act (No 3) 1972* (Cth) s 6. In 1973 the sufficient distribution provisions were again amended, this time with respect to avoidance schemes which achieved compliance with the distribution requirement by ensuring that distributions were a part of a dividend stripping operation; *Income Tax Assessment Act 1973* (Cth) ss 16-17.

\(^{182}\) See the discussion of the relevant case law in: CAS, ‘Revenue Note’ (1975) 49 *Australian Law Journal* 590.

\(^{183}\) For a review of various methods of income splitting, and recognition of the impact of the revised s 103A upon the retention of profits within the corporate form, see: C Cullinan, ‘Latest Developments in Tax Planning’ (1975) 49 *Australian Law Journal* 353, 357. The increasing use of trusts is recorded in Commonwealth, *Reform of the Australian Taxation System (Draft White Paper)*, above n 61, 52-3. The number of trusts increased from 117,616 in 1972-3 to 258,846 in 1982-3.
requirement had been increased to 50%. Given that the rate of tax imposed upon private companies remained significantly below the top marginal rate of tax, high income taxpayers retaining profits in their companies obtained a significant tax advantage even if the sufficient distribution provisions were applied to the profits in excess of the 50% retention allowance. The belated success of the Commissioner in the High Court with respect to the sufficient distribution provisions was of minimal consequence in the overall scheme of things - the government had ultimately conceded ground to the discourse of fostering private enterprise by forsaking the discourse of equity which mandated equal treatment for all taxpayers. Further, taxpayers had moved on to more fertile fields of tax minimisation.

**Conclusion**

From the outset, the sufficient distribution requirement represented an ambivalent compromise between the competing discourses of tax equity, fostering corporate investment, administrative expedience, maintaining the rule of law and raising revenue. The preceding discussion of the case law concerning the sufficient distribution requirement suggests that the legislative ambivalence was duplicated in the legal realm - taxpayers and the Commissioner offered alternative interpretations drawn from competing standpoints. It has been argued that in all of the cases brought before the courts choices, subconscious or overt, were made by the judges deciding them. Although the existence of choice between competing interpretations in itself is uncontroversial, the preceding discussion of the case law supports the more controversial proposition that there was nothing in the legislation itself which necessarily dictated the respective outcomes ultimately adopted by the court in these cases. Certainly, there was nothing in the judgments which offered a

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184 In 1973 the *Income Tax Assessment Act (No 5) 1973 (Cth) s 24* amended the retention allowance with respect to most private income to 50% of the distributable income of the relevant
convincing account of how the result was achieved by the application of the
‘literal’ meaning of the statutory words. It may be accepted that, in most or all
of the cases, the respective interpretation of the legislation adopted by the court
was plausible. However, in each case the interpretation ultimately adopted by
the court was merely one of several quite plausible interpretations, rather than
the one ‘right’ interpretation. The suggestion that the Australian courts of
yesteryear discovered the literal meaning of the legislation is therefore
unconvincing, notwithstanding the repeated judicial references to the
methodology of literalism.

The account of judicial literalism is also flawed for a second reason. Even if it
is accepted that judges accurately describe what they do, there is a wealth of
evidence to suggest that at no time did the courts consistently purport to adhere
to the literalist method. The existence of judicial discretion with respect to
methodological rhetoric is reflected in the fact that the courts variously
purported to adopt a literal interpretation, a purposive construction, a
business or commercial understanding of the statutory terms and at other
times a technical reading of the relevant provision. In this regard the
sufficient distribution case law is not atypical. A review of the income tax case
law more generally indicates that the courts, for no apparent reason, oscillated
between the various rhetorical poles of literalism (variously understood), a
purposive construction and even occasionally the odd express recognition of

\[\text{company.}\]

\[185\text{ See, for example, Cornell, above n 136.}\]

\[186\text{ See, for example, Kellow-Falkiner, above n 141; Adelaide Motors, above n 155.}\]

\[187\text{ Herbert Adams Pty Ltd v Federal Commissioner of Taxation (1932) 47 CLR 222, 226}
(Starke J), 227 (Dixon J); FCT v St. Huberts Island Pty Ltd 78 ATC 4104, 4112.}\]

\[188\text{ Keighery, above n 166; Sidney Williams, above n 169; Casuarina, above n 179.}\]

\[189\text{ Swinburne v FCT (1920) 27 CLR 377, 383, 386; Premier Automatic Ticket Issuers Ltd v}
FCT (1933) 50 CLR 269, 298 (Dixon J); National Mutual Life Association of Australasia Ltd v}
FCT (1970) 122 CLR 13; FCT v ICI Australia Ltd (1972) 127 CLR 529, 542, 564.}\]

\[190\text{ MP Metals Pty Ltd v FCT (1967) 117 CLR 631, 633 (Windeyer J).}\]
judicial pragmatism, although there were widely divergent views upon the respective meanings of these methodologies.

The courts therefore exercised discretion at two levels: firstly, at the level of methodological rhetoric; and secondly in choosing between competing substantive interpretations of the relevant provision. Given the existence of these choices it might be considered odd that the judges did not expressly address themselves to the exercise of these discretions. Indeed, one striking aspect of the sufficient distribution case law is the rhetoric of certainty with which the existence of judicial choice is apparently erased from the judicial determination of statutory meaning. The reliance of Dixon J upon the ‘inevitable consequence’ of his premise in Neal’s Motors, the view of the High Court in Adelaide Motors that the purpose of the sufficient distribution requirement was to treat some companies in the same way as partnerships and the point blank exclusion of the ‘practical’ meaning of control in favour of the ‘legal’ meaning in Sidney Williams and Keighery are just some examples of the rhetoric of judicial certainty erasing the existence of judicial discretion.

The judicial methodology and rhetoric in the Australian income tax case law prior to 1980 therefore evidences a substantial similarity to that employed by the British courts of the Victorian era. The Australian case law indicates that the judges exercised substantial discretion in the interpretation of the income tax legislation, while simultaneously purporting to merely ‘discover’ the meaning of

191 At various times Dixon CJ conceded that judicial pragmatism was a necessary facet of the adjudication of cases: ‘[t]he resource of ingenious minds to avoid revenue laws has always proved inexhaustible and for that reason it is neither possible nor safe to say in advance what must be found, after a scheme is struck down under s 260, before a consequential assessment can be justified’; FCT v Hancock (1961) 8 AITR 328, 333; see also: Hallstroms Pty Ltd v FCT (1946) 72 CLR 634, 648 (Dixon J). The so called personal exertion rule may be another example of judicial pragmatism - the personal exertion rule has been recognised as an example of the preparedness of the courts to effectively legislate against once form of tax minimisation in the absence of any legislative basis for the rule: FCT v Everett (1980) 143 CLR 440, 453.
192 See above n 147.
193 See above n 155.
194 See above n 166.
the legislation. Once again, then, the question of why the judiciary said one thing whilst doing another must be addressed. The reasons for why the judiciary’s portrayal of its method was generally accepted both by the judiciary and by ‘outsiders’ are the same as the reasons for the rationalisation of the judicial method in Victorian Britain. 195 Legal formalism offered a compelling, sweet nectar drawn from the rhetorical sources of scientific method, prevailing language theory and the rhetoric of individual rights under a constitutional democracy. Indeed, the commentators embellished the judicial concern regarding the subject’s property rights by suggesting that the instances of literalist rhetoric in the tax cases aptly described all tax decisions, in that the courts purportedly adopted the strict meaning of the legislation. Of course, there are some judicial statements which supported this proposition. However, the preceding discussion of the case law indicates that this account could not be reconciled with a large number of judicial descriptions of interpretative practice, as the courts often expressly referred to alternative interpretative methodologies including the legislative purpose and judicial pragmatism. Nevertheless, as the twentieth century progressed, the threads of this depiction of judicial method began to unravel, particularly in the context of taxation law.

195 See the conclusion to chapter three, above.
A Introduction

In chapters three and four it was argued that adherence to a literalist methodology in tax matters was perceived to be the keystone of the legitimacy of the courts in both the United Kingdom and Australia until the late 1970's. However as the 1980's dawned there was a marked shift in the interpretative rhetoric adopted by the Australian courts. Literalism was spurned and displaced by a renewed emphasis upon intentionalism or purposive interpretation of legislation. This fundamental shift was broadly portrayed as a necessary corrective to the excessive literalism adopted by the courts, particularly in the era of Sir Garfield Barwick's tenure as Chief Justice of the High Court of Australia. The literalism of the courts, it is generally accepted, jeopardised the legitimacy of the courts and the tax system, and thereby threatened the foundations of the modern democratic state. The issue which I want to address in this chapter is whether this shift in judicial rhetoric has been matched by a shift in the judicial practice of tax interpretation.

B The Reorientation of Interpretative Rhetoric

The 1970's were marked by high income tax rates on a progressive scale, a relatively narrow income tax base and high inflation rates. High inflation rates, and the refusal of the Commonwealth government to index the income tax rate thresholds to inflation, meant that many taxpayers were caught by 'bracket creep', the phenomenon of rising nominal incomes triggering higher tax rates despite the fact that the taxpayer's 'real' income (in terms of market power) had not increased. As a result, taxpayers earning average weekly earnings were

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2 Ibid, 49-53.
paying tax at rates which had hitherto been the preserve of the wealthy.\(^3\) Meanwhile wealthier taxpayers in a position to alter the legal form of their income, or the channels through which it was derived, were in a good position to take advantage of the many lacuna in the income tax base.\(^4\) Provided that they were well advised, such taxpayers could minimise their tax liability or escape paying tax altogether. Indeed, with careful planning, the wealthy could not only minimise their income tax, but also receive an attractive slice of the fruit distributed by the burgeoning welfare state. The works of the late Peter Clyne capture this mood of aggressive tax planning which infected the Australian tax scene from the 1960's.\(^5\) Whether or not the wealthy had always had access to tax minimisation arrangements,\(^6\) the Australian income tax system was increasingly portrayed as riddled with loopholes and wracked with crisis.\(^7\) The extent of the problem confronting the Australian tax system was apparent to policy advisers and academics,\(^8\) who drew upon the literature of public finance\(^9\)

\(^3\) Ibid.
\(^4\) Ibid, passim.
\(^6\) The development of the sufficient distribution requirement, discussed in chapter four, and judicial decisions such as *DFCT v Purcell* (1921) 29 CLR 464, suggests that there was a considerable amount of tax minimisation undertaken in the pre war period, although at this stage little research has been undertaken with respect to early tax avoidance in Australia. After *Purcell* the Commissioner noted that such arrangements had become 'a widespread practice throughout Australia amongst persons who have been liable to assessment of income tax in the higher grades of income... with the result that, although the same financial benefit accrues annually to the family as a whole and is enjoyed by the family, the total amount of income tax payable on the total financial benefit is greatly reduced.' Commonwealth, *Tenth Report of the Commissioner of Taxation*, Parl Paper No 96 (1926-1927) 14.
\(^8\) In the 1960's a tax reform booklet had been commissioned by the Social Science Research Council in response to the limited terms of reference conferred upon the Ligertwood Committee. The report that emerged depicted a tax system riddled with loopholes: RI Downing, HW Arndt, AH Boxer and RL Mathews, *Taxation in Australia: Agenda for Reform* (1964). For another early discussion of the problems confronting the income tax systems of Australia and New Zealand, see: I Richardson, *Attitudes to Income Tax Avoidance* (1967) 13. For recognition of
and also looked abroad to the substantial changes wrought to the tax systems in other countries. However, the depiction of the perceived threat to the welfare state was not restricted to the corridors of academia or the odd fleeting official reference to the problem. Over the course of the 1970's and the early 1980's, the media repeatedly highlighted the perceived inequity of the well advised wealthy failing to contribute their fair share to the commonweal.10 Parliamentary references to tax avoidance reflected the growing public concern, while in the High Court Murphy J occasionally expressed his concerns for the survival of the Australian welfare state.11

The depiction of the Australian tax system in crisis, and the responses to the crisis, were influenced by the various discourses outlined at the beginning of chapter four.12 From the standpoint of those advocating the merits of the expanding welfare state, the tenet of wealth redistribution was jeopardised by the tax dysfunction of the 1970's.13 On the other hand, some of those that...
attached a high priority to the rule of law denied that there was a crisis at all, suggesting that the existence of 'tax avoidance' was evidence that the rule of law was functioning in accordance with the standards of a society which valued individual freedom and property rights.\textsuperscript{14} The 1970's and early 1980's were therefore an era in which the competing discourses of the welfare state and economic liberalism clashed most spectacularly.\textsuperscript{15} This struggle between competing discourses focused critical attention upon the role of the courts in the tax crisis.

Those concerned at the widespread minimisation of tax focused upon what was perceived to be the preparedness of the courts to adopt a 'literal' reading of tax legislation in upholding tax avoidance schemes.\textsuperscript{16} Although the Barwick High Court of the late 1970's purported to be doing no more than complying with entrenched common law doctrines by enforcing the strict literal meaning of the legislation,\textsuperscript{17} the critique of this interpretative standpoint gathered considerable momentum over the late 1970's and early 1980's.\textsuperscript{18} The interpretation of

\textsuperscript{14} A Shenfield, \textit{The Political Economy of Tax Avoidance} (1968) 35.


\textsuperscript{17} FCT v Westraders, above n 11, 4358 (Barwick CJ). In the context of the doctrine of precedent, Sir Garfield Barwick stressed the function of the court in finding 'the law'; Sir Garfield Barwick, 'Precedent in the Southern Hemisphere' (1970) 5 \textit{Israel Law Review} 1, 21-2.

\textsuperscript{18} See, for example, Yuri Grbich, 'Section 260 Reexamined: Posing Critical Questions about Tax Avoidance' (1975) 1 \textit{University of New South Wales Law Journal} 211; Yuri Grbich, 'The Duke of Westminster's Graven Idol on Extending Property Authority into Tax and Back Again'
statutes in the period of the Barwick High Court was characterised as 'pedantic', motivated by policy considerations and marked by the failure of the courts to find the true law.\textsuperscript{19} Desperate situations call for desperate measures, some critics suggested. These critics proposed an abandonment of the rule of law discourse underpinning the formalism of a literalist approach, and called for a substantial expansion of the Commissioner's discretionary powers to combat 'tax avoidance'.\textsuperscript{20}

However, not all were prepared to abandon the discourse of the rule of law to the winds of administrative discretion in this way. If respect for the rule of law collapsed, it was suggested, then the very foundations of the Australian political system would be threatened.\textsuperscript{21} Many of those who accepted that the tax system was in crisis therefore remained faithful to the rule of law discourse. Some of these commentators suggested that the crisis had arisen because of the tardy and ad hoc piecemeal reform of the preceding seventy years, a problem which could be resolved by root and branch surgery upon the income tax base.\textsuperscript{22} According to these commentators, once the legislature clearly expressed what was subject to tax, the literalism of the courts would be an effective tool in the repair of the

\textsuperscript{19} Lehmann, above note 18, passim.

\textsuperscript{20} Commonwealth, \textit{Taxation Review Committee - Full Report}, Parl Paper No 136 (1975) 382. As we saw in the context of the sufficient distribution requirement. The consequence of such an expansion of administrative discretion being that the role of the courts in tax administration would be largely eliminated.


income tax system. However those endorsing literalism in this way struggled to overcome the negativity towards 'literalism' which was associated with judicial complicity with anti-social behaviour. The greater weight of opinion therefore accepted that the tax system was in crisis, and that the literalist method purportedly adopted by the courts was largely responsible for this problem. Pressure mounted for a reconsideration of the judicial role, and in particular a revision of the judicial approach to the interpretation of legislation in general and tax legislation in particular.

At the core of this critique was a reexamination of the assumptions regarding the referential capacity of language which had sustained the rhetoric of literalism, a reexamination in part attributable to the resurgence of interest in intentionalist theory over the 1960s and 1970's. Language was often portrayed as an imperfect medium for conveying the author's intended meaning. The referential certainty of Mill's era and the apparent rigidity of the connotation/denotation dichotomy of the Dixon court had by now been displaced by a distrust of language. Even liberal lawyers such as Hart recognised that the 'slot machine jurisprudence' consistent with a referential theory of language was no more than a 'noble dream'. Once the 'science' of interpretation was considered to stand on shaky foundations, the two discourses critical to the perceived legitimacy of literalism unravelled. This was a

23 Ibid.
26 For further discussion of this point see below, chapter 6, under the heading 'Intentionalist Theories of Determinacy'.
watershed moment in legal language theory, as the Australian community stood at the crossroads. Behind lay the reassuring interpretative rhetoric of the Victorian era, ahead lay uncertainty. It was apparent to many that there was a choice between the perceived anarchy of legal realism or, alternatively, a new theory of interpretation consistent with the certainty depicted in the rule of law maxim.28

In chapters three and four it was noted that, over the preceding century, the British and Australian courts had frequently expressly referred to a purposive interpretative rhetoric when interpreting tax legislation.29 In the early 1980's there was a marked rhetorical shift towards this purposive rhetoric. Although there had been some earlier indications of this shift in the context of 'tax avoidance' cases,30 the common law rules of statutory construction were reconsidered in globo by Mason and Wilson JJ in the decision of Cooper Brookes (Wollongong) Pty Ltd v FCT.31 The joint judgment of Mason and Wilson JJ was seized upon by the commentators as the most direct statement of this reorientation towards a rhetoric of purposive interpretation:

> [W]hen the judge labels the operation of the statute as "absurd", "extraordinary", "capricious", "irrational", or "obscure" he assigns a ground for concluding that the Legislature could not have intended such an operation and that an alternative interpretation must be preferred. But the propriety of departing from the literal interpretation is not confined to situations described by these labels. It extends to any situation in which for good reason the operation of the statute on a literal reading does not conform to the legislative intent as ascertained from the provisions of the statute, including the policy which may be discerned from those provisions. Quite obviously questions of degree arise. If the

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28 That this perception pervaded legal consciousness is reflected in the title of Hart’s paper: ibid.
31 81 ATC 4292.
choice is between two strongly competing interpretations, as we have
said, the advantage may lie with that which produces the fairer and more
convenient operation so long as it conforms to the legislative intention.
If, however, one interpretation has a powerful advantage in ordinary
meaning and grammatical sense, it will only be displaced if its operation
is perceived to be unintended.32

This statement reflects an attempt to synthesise three rival theories of language
in its accommodation of literalism, intentionalism and pragmatism, but for
present purposes it is sufficient to note that at the time of the judgment it was
widely contrasted with what had been perceived as the consistent application of
the literal meaning of tax legislation by the Barwick High Court.33

Whilst with the benefit of hindsight Cooper Brookes may be depicted as a
revolutionary decision marking a new era of cooperation between the courts and
the legislature in achieving the legislative intention, at the time there was less
confidence in the commitment of the High Court to combat tax avoidance. The
Parliament therefore sought to entrench this shift to a purposive methodology by
inserting sections 15AA and 15AB into the Acts Interpretation Act 1901.34
Although some had perceived a shift to this purposive rhetoric slightly earlier,35
the decision in Cooper Brookes and the legislative amendments have been
widely interpreted as having ushered in a new era of purposive construction of

32 Ibid 4306. For further discussion of this case see: ICF Spry, ‘The Cooper Brookes Case and
Pendulum: Judicial Trends in the Interpretation of Revenue Statutes’ (1996) 19 University of
New South Wales Law Journal 162; Jeffrey Barnes, ‘Statutory Interpretation, Law Reform and
33 Although it should be noted that even Sir Garfield Barwick did not adhere rigorously to a
rhetoric of literalism. See, for example, his reliance upon a purposive rhetoric in Mullens v FCT
76 ATC 4288, 4292.
34 Section 15AA was inserted into the Acts Interpretation Act by the Statute Law Revision Act
1981 (Cth), to take effect from 12 June 1981. Section 15AB was inserted in 1984 by the Acts
Interpretation Act Amendment Act 1984 (Cth).
Australian Tax Review 81, 103.
tax legislation according to which the courts take account of policy considerations and the legislative intention.\textsuperscript{36}

The perceived crisis of tax avoidance had therefore precipitated a reexamination of the common law and statutory rules governing statutory interpretation, culminating in the rhetorical shift to a discourse of purposive interpretation. Whilst this shift is often depicted as a significant revolution in Australian jurisprudence, in a sense there was little change in the underlying theory of statutory interpretation. As with the literal theory of statutory interpretation, a purposive theory remained faithful to the tenets of judicial discovery of law made by Parliament without recourse to underlying moral norms, was consistent with the liberal fear of excessive administrative power embodied in administrative discretions and also accorded with the belief that tax law ought be clear such that taxpayers might readily ascertain their tax liability. The discourses of individual rights and the science of objective legal discovery were therefore reconfigured within a purposive rhetoric which signalled the rejection of any acknowledgement of legal realism. Nevertheless, in one fell swoop this relatively minor rhetorical shift, which preserved the norms of legal formalism, was portrayed as the answer to the perceived evils of tax avoidance and the threat to the legitimacy of the courts.\textsuperscript{37} Whether or not this approach is applied to all tax legislation, it is generally accepted that the courts adopt a purposive

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interpretation of tax avoidance provisions.\textsuperscript{38} If there was one part of the income tax legislation which might be expected to demonstrate a purposive interpretative rhetoric in this new era, then, it is in the interpretation of the general anti-avoidance provisions of the income tax legislation.\textsuperscript{39} It is therefore to the purpose of the general anti-avoidance provisions that we must now turn before examining the judicial interpretation of those provisions in the era of purposiveness.

\textbf{C The Function of General Anti-Avoidance Provisions in the Era of Purposive Statutory Interpretation}

There is widespread agreement that the concept of tax avoidance defies definition\textsuperscript{40} - one commentator analogising any such attempt to nailing jelly to

\begin{itemize}
  \item \textit{FCT v Students World (Aust) Pty Ltd} 78 ATC 4040, 4047 (Mason J). For a similar rhetoric adopted slightly earlier in the United Kingdom see: Greenberg \textit{v IRC} (1972) AC 109, 137 (Lord Reid) and IRC \textit{v Joiner} (1975) 1 WLR 1701, 1706 (Lord Wilberforce). For recognition of this approach in the secondary commentaries see: Woellner above n 36, 62; DG Hill, 'Great Expectations: What do we expect from judges in tax cases?' (1995) 30 \textit{Taxation in Australia} 21, 26-7; HH Monroe, above n 18 (criticising the doctrine on the basis of the uncertainty that it brings to taxation law). For discussion of the earlier view see Brown, above n 35, 106-7.
  \item Now found in \textit{Income Tax Assessment Act 1936} (Cth) Part IVA. It should be noted that not every jurisdiction incorporates a general anti avoidance provision within its income tax legislation. For discussion of the approach of the courts in such jurisdictions see: John Tiley, 'Judicial Anti-avoidance Doctrines: The US Alternatives' (Pt 1) [1987] \textit{British Tax Review} 190; John Tiley, 'Judicial Anti-avoidance Doctrines: The US Alternatives' (Pt 2) [1987] \textit{British Tax Review} 220.
the wall. However, one commonly accepted understanding of tax avoidance is framed in terms of the intentional minimisation of tax by means which are consistent with the letter of the tax law but are contrary to the legislative intention or purpose. The purpose of the general anti-avoidance provisions is therefore widely understood to be that of supplementing the specific taxing provisions by ensuring that taxpayers who ought be assessed under those taxing provisions are liable to tax. However this understanding of tax avoidance raises a question regarding the function of the general anti-avoidance provisions in an era of purposive statutory interpretation. If a purposive interpretation of the specific taxing provisions in the legislation is adopted, then logically there is no scope for a general anti-avoidance provision if the only function of the general anti-avoidance provisions is to ensure that the specific provisions apply to all receipts and transactions that the legislature intended to tax. On this basis, the legislative insertion of new general anti-avoidance provisions into the income tax legislation and of provisions promoting the purposive interpretation of legislation into the Acts Interpretation Act 1901 (Cth), seems inexplicable.

One solution to this conundrum is to accept that the anti-avoidance provisions are yet another example of statutory provisions inserted out of an abundance of caution, superfluous provisions which will never have any practical operation provided that the courts continue to adopt a purposive interpretation of the substantive provisions of the legislation. On this view, the general anti-

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43 Note the general acceptance that the courts are paying closer attention to the legislative purpose of the specific provisions, and particularly so in cases where ‘tax avoidance’ is concerned; see, for example, the interpretation of Income Tax Assessment Act 1936 (Cth) s 51(1) in John v FCT (1989) 166 CLR 417; Coles Myer Finance v FCT 93 ATC 4214, 4222-3.
avoidance provisions are a backstop measure, lying dormant until the courts stray from the true legislative purpose of the substantive provisions of the legislation, whence they spring into effect to catch certain benefits derived by taxpayers. However this approach is inconsistent with the legislative, judicial and secondary opinion which accepts that the general anti-avoidance provisions continue to have some practical effect, even where there is a purposive interpretation of the remaining provisions of the Act. In the context of the current provisions embodied in Part IVA of the Act, when introducing the amending Bill into Parliament the Treasurer clearly expected that Part IVA would have a practical impact upon tax avoidance arrangements, rather than Part IVA being intended as a merely precautionary measure.44 Further, there has now been a number of Federal Court and High Court decisions which have accepted that Part IVA has an effective operation,45 while the practical operation of Part IVA has never seriously been questioned in the substantial body of secondary commentary upon the provisions.46 It is generally accepted that the general anti-avoidance provisions simultaneously fulfil the intention of the specific taxing provisions and also have a practical operation. It is therefore clear that, in what is purportedly the new age of purposive construction, there must be an alternative theorisation of the function of the general anti-avoidance provisions which accounts for the practical scope that is commonly attributed to them.

The second understanding of the general anti-avoidance provisions, which gives them some practical scope, accepts a bifurcation within the concept of ‘the legislative intention’ between the legislative intention of the specific taxing

45 In particular see: *Davis v FCT* 89 ATC 4377, 4400 (Hill J); *FCT v Jackson* 90 ATC 4990; *FCT v Peabody* 94 ATC 4663; *FCT v Spotless* 96 ATC 5201.
46 Aside from the secondary material with respect to Part IVA referred to elsewhere in this chapter, see the discussion of Part IVA with references to further material in Woellner, et al,
provisions and an overarching legislative intention of the statute overall. According to this model of the income tax legislation, 'the legislative intention' is more than the sum of the 'legislative intentions' with respect to the specific taxing provisions - there is an overarching legislative purpose which the general anti-avoidance provisions are intended to fulfill. For this bifurcation of the legislative purpose to be sustained, it must be accepted that each specific taxing provision should be interpreted upon its own terms without regard to any consideration of the overarching legislative purpose. To interpret a particular provision in light of its statutory context would collapse the dichotomy between the intention of the provision and the intention of the Act upon which the bifurcation depends. Only after adopting this approach to the specific provisions of the legislation and finding that the taxpayer remains free of tax, should the general anti-avoidance provisions be considered.\textsuperscript{47} However the identification of an overarching legislative purpose, which this theorisation of the function of general anti-avoidance provisions suggests Part IVA is intended to fulfil, is most problematic.

From the overview of the often competing discourses influencing the Australian income tax legislation in chapter four, it may be seen that the balancing of the competing discourses of administrative expediency, fiscal demand, tax equity, the rule of law and the perceived need to foster capital investment has influenced the creation of an income tax base embodying ad hoc political compromises. As a result, it was often considered impossible to identify an overarching concept of income from this sea of political compromises.\textsuperscript{48} While

\textsuperscript{47} Support for this view may be found in some judicial statements suggesting that it is the purpose of the specific provision as revealed by the legislative text within those provisions which is the appropriate subject of inquiry: Keighery (W P) Pty Ltd v FCT (1957) 100 CLR 66, 87 (Dixon CJ, Kitto and Taylor JJ); Mullens v FCT (1976) 135 CLR 290, 300 (Barwick CJ); Shell v FCT (1949) 78 CLR 382, 461 (Dixon J).

\textsuperscript{48} For a critique of the income tax on these grounds see, for example, Ross Parsons, 'Income Tax - An Institution in Decay?' (1986) 12 Monash University Law Review 77; Krever, above n
some see the absence of a cohesive statutory income tax base as cause for reform, the conceptualisation and implementation of a cohesive normative income concept is problematic. Thus it is not possible to reform the income tax in accordance with one discourse, because the structuring of the Act will always be undertaken in an environment of political compromise. Further, some express, and even some implicit, exclusions from the tax base are clearly deliberately intended to encourage investment in particular activities or have deliberately been excluded from the tax net for administrative or other reasons. It is therefore accepted that many forms of receipt are deliberately not assessed to income tax, or are concessionally taxed, by the express provisions of the legislation with the purpose of encouraging the taxpayer to ‘avoid’ tax.

Perhaps because of the difficulties of identifying an overarching legislative purpose in the Income Tax Assessment Act which the general anti-avoidance provision was purportedly intended to fulfil, prior to 1980 the Australian courts had restricted the scope of s 260. The courts had often given priority to the specific provisions in the Income Tax Assessment Act, on the basis that the interpretation of s 260 was governed by the common law principle of statutory construction which maintained that, in the absence of any contrary intention, a specific provision should take priority over any general provision. Accordingly, the courts had developed the choice principle, which accepted that a taxpayer taking advantage of a tax minimisation opportunity expressly contemplated by the legislation ought be allowed to do so without the general anti-avoidance

22; M Walsh, ‘The Role of Professional Advisors and Others in Relation to Tax Avoidance’, Papers presented at the Taxation Convention of the Victorian Division of the Taxation Institute of Australia, 2-4 October 1981, 1, 4-5
50 See the material cited at n 40 above.
52 Ibid.
provision being applied. This choice principle had subsequently been
extended in the Barwick era to include any choice implicitly allowed to the
taxpayer. As a result, the general anti-avoidance provisions were generally
allowed to wither on the legislative vine as the courts gave priority to the
perceived meaning of the specific provisions of the legislation. Section 260
was therefore generally only allowed a residual effect - effectively only applying
to poorly advised taxpayers who sought to construct their existing affairs in
order to minimise tax, as opposed to taxpayers who sought to minimise their tax
from the beginning of a transaction. With the introduction of the new general
anti-avoidance provisions of Part IVA in 1981, the common law presumption
was overturned unless the legislature expressly allowed the taxpayer a choice
under the specific provisions of the Act. By thus elevating the status of the
general anti-avoidance provisions to place them on an equal footing with the
other provisions of the legislation, Parliament prompted considerable debate
concerning the legislative intention with respect to their scope.

The third alternative interpretation of the purpose of the general anti-avoidance
provisions rejects the bifurcation of legislative intention postulated by the
second alternative, and instead depicts the general anti-avoidance provisions as
another specific addition to the tax base which ought be interpreted in the same
way as any other provision in the Act. This approach therefore rejects the

53 Keighery above n 47; Cecil Bros Pty Ltd v FCT (1964) 111 CLR 430; for a more recent
recognition of this principle see John v FCT 89 ATC 4101, 4109 (Mason CJ, Wilson, Dawson,
Toohey and Gaudron JJ).
54 Mullens v FCT 76 ATC 4288; Slutzkin v FCT 77 ATC 4076; Cridland v FCT 77 ATC 4538.
55 For an overview of the limitations of s 260 see: ICF Spry, Section 260 of the Income Tax
Assessment Act (1978); H Reicher, ‘Tax Avoidance in 1977 - The Decline and Fall of Section
260’ (1978) 12 Taxation in Australia 680; Passant, ‘Tax Avoidance in Australia: Results and
56 See, for example, Bell v Federal Commissioner of Taxation (1953) 87 CLR 548. This
approach was known as the annihilation principle.
57 Income Tax Assessment Act 1936 (Cth) s 177B(1).
58 For a discussion of which, with reference to the relevant case law, see Richard Vann and
Notes International 2063, 2065.
generally accepted definition of the scope of anti-avoidance provisions, being the fulfilment of the purpose of the specific provisions of the Act. Instead this approach accepts that the purpose of the general anti-avoidance provisions is to catch receipts which are not intended to be caught by the other specific provisions in the Act and without regard to any overarching legislative purpose. 59

In many instances the legislature deliberately intends that particular receipts or transactions should be free from tax, or should be concessionally taxed. Many prudent taxpayers deliberately structure their affairs so as to fall within the express or implied legislative exclusions from the tax base in order to minimise their tax liability, and therefore fall within the generally accepted understanding of tax avoidance. General anti-avoidance provisions such as Part IVA, which are interpreted independently of the remaining provisions of the income tax legislation, catch such transactions. Under this third approach to the interpretation of the general anti-avoidance provisions, the legislature must therefore exclude from the operation of Part IVA those receipts which the legislature is taken to have deliberately excluded from the tax base regardless of such deliberate planning on the part of the taxpayer. In the case of Part IVA, the definition of tax benefit in s 177C seeks to achieve this result by excluding the operation of Part IVA from the exercise of any choice by the taxpayer expressly allowed under the Act. This third theorisation of the purpose of the general anti-avoidance provision can therefore allow the general anti-avoidance provisions of Part IVA some scope in an era of purposive interpretation, and is

59 The former Commissioner of Taxation adopted this view: Trevor Boucher, ‘Section 260/Part IVA - The Doctor’s Cases’, (1986) Papers Presented at the State Convention of The Queensland Division of the Taxation Institute of Australia 9-11 May 1986 6, 10. However one unsatisfactory aspect of this third approach to the interpretation of Part IVA is that it does not explain why this extension to the income tax base attracts penalty tax and other administrative sanctions, which indicate that the anti avoidance provisions are intended to have a punitive effect, as opposed to being merely one more addition to the income tax base.
consistent with the terms of s 177B(1) and the express exclusion of tax concessions from the operation of Part IVA.

The preceding discussion of alternative theorisations of the scope of the anti-avoidance provisions suggests that the purpose of the general anti-avoidance provisions in the Income Tax Assessment Act must be reconsidered. Whereas the generally accepted understanding of the purpose of general anti-avoidance provisions is that they merely bolster the specific provisions of the Act and ensure that the legislative purpose of those provisions is fulfilled, this understanding appears inadequate in an era when the courts are purportedly already identifying the legislative intention of the specific provisions of the Act. On the basis that the general avoidance provisions are not superfluous, and acknowledging that there is no cohesive income concept underpinning the Act, it must be accepted that the general anti-avoidance provisions have an independent operation. Under this model, the legislature must include measures designed to prevent the anti-avoidance provisions from catching receipts not otherwise subject to tax which the legislature deliberately intended should be exempt or treated concessional.\(^{60}\) Having thus identified the perceived function of Part IVA in what is purportedly an era of purposive statutory interpretation, the subject of debate in the contemporary literature is the scope of the general anti-avoidance provisions under this ‘independent operation’ model.

**D The Elements of Part IVA**

Part IVA of the Act was introduced in 1981 with the object of overcoming the perceived shortcomings of s 260 of the Act.\(^{61}\) Section 177F grants the Commissioner a discretion to reconstruct a taxpayer’s affairs in order to increase

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\(^{60}\) To some extent, the legislature has done this by the definition of ‘tax benefit’ in s 177C and also by granting priority to certain deduction provisions in the Act (Income Tax Assessment Act 1936 s 177B(3)(4)).

\(^{61}\) The shortcomings of s 260 had been dealt with at considerable length, for a selection of the literature see the material cited at n 55 above.
the taxpayer's tax liability, provided that the taxpayer has entered into a *scheme* which produced a *tax benefit* and a person, who need not necessarily be the taxpayer, had the *dominant purpose* of obtaining a tax benefit for the relevant taxpayer. Although the application of these provisions had arisen in a number of Administrative Appeal Tribunal decisions and tax rulings, it was not until the cases of *FCT v Peabody*\(^6\) and *FCT v Spotless*\(^3\) that the High Court considered the application of Part IVA. Before turning to the High Court's approach to the application of Part IVA in these cases, the facts of *Peabody* and *Spotless* will be briefly outlined.

1 *The Facts of FCT v Peabody*

*Peabody's case* involved the restructuring of a privately controlled corporate group prior to a public issue of shares representing 50% of the group's value. Prior to the relevant transactions in October 1985, the Peabody family trust held approximately 62% of the share capital of a corporate structure, for all practical purposes the remaining 38% being held by a Mr Kleinschmidt. On 14 October 1985 Mr Kleinschmidt agreed to dispose of his shares to interests associated with the Peabody family trust on the understanding that the price paid for the shares would be confidential.

For the public issue to proceed, it was decided to transfer the Peabody interests into a company, of which one half of the share capital was to be issued to the public. The consideration paid by the Peabody interests for the Kleinschmidt shares was calculated upon the basis that the corporate group had a net value of approximately $24 million. Importantly, the Peabody interests agreed with the public issue vehicle to transfer 50% of its interests in the corporate group (after acquiring the Kleinschmidt shares) for approximately $15 million (ie valuing the corporate group at $30 million). The Peabody interests were therefore to

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\(^6\) 94 ATC 4663.
derive a gain of approximately $2 million upon the purchase and sale of the Kleinschmidt shares. On 17 October 1985 Mr Peabody, the defacto controller of the Peabody trust, met with stockbrokers who advised that the difference between the purchase price of the Kleinschmidt shares and the stated value of the publicly issued shares would cause problems if disclosed to the public. The question was whether the corporate regulatory framework then in force required the prospectus to give details of the acquisition of the Kleinschmidt shares. Having sought the advice of counsel, Mr Peabody and certain advisers decided that, if the Peabody trust were to purchase the Kleinschmidt shares and dispose of them to the public issue vehicle, there was a real prospect that disclosure of the acquisition price (from Mr Kleinschmidt) would be required.

As the problem was therefore the purchase and resale of the Kleinschmidt shares, the Peabody's advisers settled upon an arrangement whereby the Peabody interests would purchase the Kleinschmidt shares, convert them to a class of shares which was virtually worthless, and then transfer 50% of the Peabody shares to the public issue vehicle. In the end, a shelf company (Loftway Pty Ltd) which was wholly owned by the Peabody trust, acquired the Kleinschmidt shares on 13 December 1985. On 20 December 1985, the companies within the corporate group converted the Kleinschmidt shares, with the consent of Loftway, to virtually valueless "Z" class shares. As a result, the shares held by the Peabody interests, which formerly represented 62% of the share capital (by value) of the corporate group, represented almost 100% of the share capital by value. In short, the value of the Kleinschmidt shares had been shifted to the Peabody trust without any change in the number of shares directly held by the trust. This shift in share value resolved the disclosure issue, but also fortuitously meant that the two million dollar gain derived by the Peabody group from the acquisition and disposal of the Kleinschmidt shares was free of tax. At the time, s 26(a) provided that any profit arising from the acquisition and

[63 96 ATC 5201.]
disposal of an asset within 12 months was to be included in the taxpayer's assessable income. Had the Peabodys acquired the Kleinschmidt shares and disposed of them to the public issue vehicle, as was originally mooted, they would have been liable for tax upon the profit. An adjunct to this arrangement was the fact that the purchase of the shares by Loftway was financed by the issue of redeemable preference shares to the financier, the dividends being calculated in light of the 100% rebate to which the financier would be entitled under s 46. Although at the time such redeemable preference share financing was considered to be consistent with the taxation law, it was subsequently branded as tax avoidance and effectively negated by the insertion of an express provision into the Act.\(^{64}\)

2 The Facts of FCT v Spotless

In *Spotless* the taxpayer had undergone a successful public float, as a result of which it had received a sum of forty million dollars which was available for short term investment. The facts provided in all of the judgments in the Federal Court and the High Court do not indicate why the taxpayer only intended to invest this sum for the short term, but this seems to have been accepted by all of the judges. After canvassing several investment houses, the taxpayer entered into an arrangement sponsored by Bankers Trust Australia. Under this arrangement, funds were invested with the Cook Islands registered bank European Pacific Banking Company Limited. Security for this borrowing was given to the taxpayer in the form of a letter of Credit issued by Midland Bank plc. At all times the taxpayer was careful to ensure that the source of the income from this investment would be outside of Australia for taxation purposes. The advantage of the transaction to the taxpayer was that the interest would be exempt from Australian tax pursuant to s 23(q) of the ITAA, while the Cook Islands government only required payment of 5% withholding tax.

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\(^{64}\) *Income Tax Assessment Act 1936* (Cth) s 46D.
Although the rate of interest on the lending was several percentage points lower than that obtainable with investments of similar security in Australia, the result was that the taxpayer derived approximately $2.3 million free from Australian tax, which was a greater after tax return to the taxpayer than that available from similar investments in Australia.

3 The Definition of ‘Scheme’

A ‘scheme’ is broadly defined in s 177A as meaning any form of agreement or understanding, presumably between two parties, and also as any ‘scheme, plan, proposal, action, course of action or course of conduct’. Subsection 177A(3) merely provides that the second limb of the definition is also to apply to unilateral schemes, actions, and so forth.

Prior to the High Court decisions in Peabody and Spotless, there had been considerable speculation as to how Part IVA would apply in particular cases. This speculation had been fuelled by a number of AAT decisions. One key element of this speculation was how the definition of ‘scheme’ ought be interpreted. On the one hand, some commentators favoured a broad definition of ‘scheme’ in s 177A, relying upon the fact that scheme was defined as meaning, inter alia, ‘any act’. This approach also seemed to be supported by s 177D, which applied where a person with the requisite dominant purpose had entered into or carried out just part of a scheme. Section 177D therefore implied that it was sufficient for the purposes of Part IVA to focus upon part of a scheme in considering whether the threshold requirements of s 177F were satisfied. On the other hand, to those concerned about the expansion of the

65 One of the more significant decisions was Case W58 89 ATC 524. For a discussion of this case see: Julie Cassidy, ‘Case W58: Death Knell for Family Companies and Trusts?’ (1992) 26 Taxation in Australia 479; Mark Burton and Justin Dabner, ‘Part IVA - Walking the Dog’ (1992) 26 Taxation in Australia 607, 609-10.
Commissioner's discretionary powers under the Act, the broad definition of scheme raised concerns that Part IVA had invested the Commissioner with an 'ultimate' discretion. According to this view, many 'prudent' business people characterise tax as just one among many business expenses. In structuring their affairs it is therefore sensible for them to minimise that expense, without necessarily entering into arrangements which are blatantly contrived for the purposes of tax avoidance. The broad definition of 'scheme' contained in s 177A(5), and in particular the fact that a scheme can apparently mean any one act, poses a threat to this commercial understanding of Part IVA. This is because it suggested that any step in a complex business transaction could be identified as a scheme. If the Commissioner could scrutinise every business transaction and isolate one step from among what may be hundreds of steps, it was suggested, the Commissioner would effectively have a power to apply Part IVA to any business transaction entered into by prudent business people. Indeed, it was even possible that obtaining advice upon the taxation implications of any proposed business arrangement would be fraught with danger, unless the taxpayer opted for the arrangement which generated the greatest tax liability. To do otherwise, by implementing parts of a broader


68 See, for example, Michael Binetter, 'The Interpretation of Part IVA after Gulland, Watson and Pincus' above n 21; DG Hill, 'A New Interpretation of s.260 and its implications for Part
arrangement which lowered the tax burden, might have been considered to be the implementation of a 'scheme' with the requisite purpose of obtaining a tax benefit. It was argued that penalising taxpayers who obtained tax advice and prudently opted for the arrangement which achieved the desired business objective and the lowest tax liability would be a nonsensical interpretation of Part IVA. After all, in introducing Part IVA, the Treasurer the Hon John Howard had suggested that Part IVA was only intended to catch blatant, artificial and contrived tax avoidance arrangements.\(^6\)

Further, there seemed to be some support for this limitation upon the scope of 'scheme' in the terms of Part IVA itself. Firstly, whilst acknowledging the breadth of the definition of 'scheme' in s 177A, it was arguable that the reference to 'scheme' implicitly meant all logically connected actions.\(^7\) The second argument noted the reference to 'parts of a scheme' in s 177D, but queried why it was necessary to specifically refer to a part of a scheme if a 'part' of a scheme could be a scheme in itself.\(^7\)

The arguments for a more limited administrative discretion were appealing from the standpoints of the rule of law and business taxpayer discourses - there is clearly a concern to constrain the Commissioner's discretion within the confines of determinate law in order to engender certainty for business taxpayers making investment decisions.\(^7\)

From the perspective of these discourses there were therefore compelling pragmatic arguments for

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\(^7\) Burton, above n 70.

\(^7\) A humorous review of this approach may be found in Neil Forsyth, 'The Bank Manager and the Big Black Dog' (1991) 20 *Australian Tax Review* 107.
limiting the Commissioner’s power to dissect a scheme into component ‘schemes’.

On the other hand, from the perspective of those concerned to eliminate the ‘scourge’ of tax avoidance, there were compelling pragmatic arguments for adopting a broad interpretation of the Commissioner’s powers under Part IVA.73 This view was founded upon the fear that if the definition of ‘scheme’ did not grant the Commissioner a broad discretion, well advised taxpayers would once again be successful in slipping the tax net, compromising the integrity of the income tax and undermining the welfare state.74 Those wanting an ‘effective’ general anti-avoidance provision therefore worried about the potential limitations of the interpretation of ‘scheme’ in accordance with the approach outlined in the preceding paragraph. In particular, they recognised that if a scheme could only comprise all of those elements which were logically connected, the consequent broadening of the meaning of ‘scheme’ might make it difficult to identify the requisite tax benefit and dominant purpose.75 The more actions that a scheme included, the more likely that the taxpayer would be successful in arguing that, in the absence of the scheme, there would not have been a greater tax liability.76 The broader a scheme became, the more likely that the taxpayer would be able to point to a multitude of purposes in arguing that the tax minimisation purpose was relatively insignificant.77

4 The Approach of the High Court to the Definition of ‘Scheme’

From the preceding discussion it may be seen that there were plausible alternative interpretations of ‘scheme’, with substantial implications for the potential scope of Part IVA. Given that Peabody was the first decision dealing

74 Ibid; Grbich above n 67.
75 Burton and Dabner, above n 65, 609.
76 Ibid.
77 Ibid.
with the meaning of Part IVA to be handed down by the High Court, and given
the existence of these competing interpretations, it might have been expected
that the High Court would give a detailed elaboration of its reasons for
preferring one interpretation of 'scheme' over another. However, the High
Court purported to discover the one true meaning of 'scheme' without
considering the competing interpretations to any significant degree.

The High Court initially indicated that it was not prepared to accept that a
scheme necessarily comprised all logically or temporally related conduct in
accordance with the concerns of business taxpayers noted above:

If, within a wider scheme which has been identified, the Commissioner
seeks also to rely upon a narrower scheme as meeting the requirements
of Pt IVA, then in our view there is no reason why the Commissioner
should not be permitted to do so.\(^{78}\)

However, the High Court appeared to make some concession to the concerns of
business taxpayers when it observed that:

Pt IVA does not provide that a scheme includes part of a scheme and it
is possible, despite the very wide definition of a scheme, to conceive of a
set of circumstances which constitutes only part of a scheme and not a
scheme in itself. That will occur where the circumstances are incapable
of standing on their own without being "robbed of all practical
meaning". In that event it is not possible in our view to say that those
circumstances constitute a scheme rather than part of a scheme merely
because of the provision made by ss 177D and 177A.\(^{79}\)

Shortly after making this statement, the High Court once again suggested that its
reading of s 177D 'does not mean that if part of a scheme may be identified as a
scheme in itself the Commissioner is precluded from relying upon it as well as
the wider scheme.' Reading these three statements with respect to the definition
of 'scheme' together, they might be understood to suggest that, although a part

\(^{78}\) 94 ATC 4663, 4670.
of a scheme can be a scheme in itself, the criterion for differentiating between schemes and parts of schemes is that a scheme must be capable of having some, however slight, 'practical meaning'. On this interpretation it is open to the Commissioner to define any number of schemes with more or less actions of the taxpayer, provided that all of those schemes have some 'practical meaning'. This 'practical meaning' test therefore appears to constitute a compromise between the broad and narrow interpretations of the definition of scheme which had been proposed by various commentators and judges prior to the High Court decision in Peabody. It seems to offer a balance between the two extremes by allowing considerable flexibility to the Commissioner, whilst preventing the Commissioner from adopting the 'extreme' stance of breaking any transaction into its component parts and treating each part as a scheme.

Although the High Court did not offer a detailed consideration of the competing interpretations of the definition of scheme in its judgment, the High Court suggested that its conclusion was justified by reference to a House of Lords decision with respect to the income tax of the United Kingdom. In Brebner, the House of Lords was called upon to interpret s 28 of the Finance Act 1960 (UK). In this case the taxpayers acquired control of a coal supplier in which they had previously held shares. The reason for taking control of the company was to preserve the favourable terms upon which coal was supplied to the taxpayer, terms which would be renegotiated to the detriment of the taxpayer had the coal supplier been acquired by a third party. After the takeover, some of the capital reserves of the coal supplying company were paid to the taxpayers in

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79 Ibid.
80 Inland Revenue Commissioners v Brebner [1967] 2 AC 18, 27 (Lord Pearce).
81 Section 28 provided that 'Where ...(b) in consequence of a transaction in securities or of the combined effect of two or more such transactions, a person is in a position to obtain, or has obtained, a tax advantage, then unless he shows that the transaction or transactions were carried out either for bona fide commercial reasons or in the ordinary course of making or managing investments, and that none of them had as their main object, or one of their main objects, to enable tax advantages to be obtained, this section shall apply to him in respect of that transaction or those transactions'.

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a tax free form, these distributions of capital being used to repay some of the
debt incurred in acquiring control of the company. The Inland Revenue
Commissioner conceded that the acquisition of the coal supplier was undertaken
for commercial purposes, but argued that the subsequent distribution of capital
to the taxpayer was not a part of the acquisition transaction and ought be viewed
in isolation. When viewed in isolation, the Commissioner contended, the only
reason for the distribution of capital was one of tax avoidance, and accordingly
the Commissioner sought to apply s 28 of the Finance Act. The House of Lords
held that the Special Commissioner of Taxes had rightly considered the
acquisition and subsequent capital distribution together, but offered little
guidance for delimiting a particular arrangement.

The most perplexing aspect of the High Court’s reliance upon Brebner is that
the High Court did not expressly reconcile the test adopted by the House of
Lords with the apparent breadth of the definition of ‘scheme’ in s 177A, which
expressly includes ‘any action’. This oversight is all the more striking, in the
context of the High Court’s rejection of one of the Commissioner’s submissions
with respect to the meaning of scheme, by its reliance upon the literalist
proposition that ‘Pt IVA does not provide that a scheme includes part of a
scheme’. If the High Court is understood to have required express statutory
authorisation for the Commissioner’s contention, the same argument could have
been applied in rejecting the ‘practical meaning’ test, given the absence of any
express statutory foundation for it. The effect of the High Court’s reference to
Brebner was that the High Court portrayed itself as constrained from
considering alternative interpretations of ‘scheme’ in the context of Part IVA.
Yet the High Court did not explain why, in what was its first decision upon Part
IVA, it considered itself constrained by a merely persuasive decision of the
House of Lords. The reliance upon the decision in Brebner therefore obscures

82 94 ATC 4663, 4670.
83 IRC v Brebner [1967] 2 AC 18, 27.
a number of matters which the High Court failed to consider - the presentation of the result in Brebner as determinative of the meaning of scheme is a rhetorical device which erases the plethora of choices confronting the High Court in the interpretation of 'scheme'.

This erasure is all the more profound when the problematic nature of the High Court’s interpretation of the definition of 'scheme' is considered in the light of the circumstances of Peabody itself. Most importantly, the High Court overlooked the alternative interpretations of the 'practical meaning' test that were open on the facts of Peabody. The 'practical meaning' of any set of circumstances could be dependent upon a full appreciation of the means adopted in creating those circumstances, the contemporaneous setting (however broadly defined) of those circumstances and also the practical consequences of those circumstances. Thus, for example, it might be suggested that the devaluation of the Kleinschmidt shares, and their subsequent sale are incapable of having any practical meaning without taking into consideration such matters as the long association between the Peabody and the Kleinschmidt interests, the transfer of the shares from Kleinschmidt to Loftway, the financing of this acquisition, the concerns regarding the perceived need to disclose the acquisition price of the Kleinschmidt shares in the course of the public issue and the tax consequences arising from the dealings. It might even be suggested that the 'practical meaning' of the share devaluation could only be ascertained after taking into account the social context of the scheme. A plausible interpretation of the 'practical meaning' test might therefore suggest that the relevant scheme in Peabody embraced all of those elements which were originally identified by the Commissioner in defining the scheme for the purposes of the first instance hearing of the case.84 Indeed, in the latter part of its judgment, the High Court

apparently proceeded upon the assumption that the wider definition of scheme originally identified by the Commissioner was the appropriate definition of the scheme in this case.\textsuperscript{85} However, in the earlier part of its judgment, when specifically addressing the application of 'scheme' to the circumstances of the \textit{Peabody} case, the High Court accepted that just the share devaluation and subsequent share disposal could be a scheme for the purposes of Part IVA.\textsuperscript{86} This conclusion was reached without any consideration as to why the isolation of the share devaluation and subsequent sale of the devalued shares did not rob those circumstances of all practical meaning.

Given that the practical meaning test might be interpreted in a variety of ways, what was the basis for the scheme identified by the High Court on the facts of \textit{Peabody}? The High Court did not expressly consider alternative applications of the practical meaning test to the circumstances in choosing the one which it considered to be most appropriate. Instead, the High Court ignored the possibility of alternative interpretations, and accepted the narrow definition of 'scheme' identified by O'Loughlin J at first instance. In reaching this conclusion, the High Court on three occasions in less than one page of its judgment prefaced its conclusion with the phrase 'in our view'. No reasons were given for the formation of their view - all that was presented was an erasure of the plurality of competing interpretations in what was portrayed as a statement of monosemic law. From the foregoing discussion, it may be seen that this apparent monosemicity belies the plurality latent within the concepts of 'practical meaning' and 'scheme' applied by the High Court. In \textit{Spotless} the High Court did not elaborate upon the application of the practical meaning test

\textsuperscript{85} The High Court considered why a company such as Loftway was a necessary part of the taxpayer's arrangements, although this issue was irrelevant to ascertaining the existence of a tax benefit if just the share devaluation by Loftway (rather than the creation of Loftway, the acquisition of the Kleinschmidt shares by Loftway, the redeemable preference share financing of this acquisition, the subsequent share devaluation and public issue) was taken to be the relevant scheme.

\textsuperscript{86} 94 ATC 4663, 4670.
to the facts of the particular case, being prepared to accept the definition of 'scheme' adopted by the majority in the Full Federal Court. In turn, the consideration of the practical meaning test by the majority of the Full Federal Court comprised merely a passing reference to the issue, rather than any critical discussion of the problematic nature of the test in its application to particular facts.

Having regard to the cursory statements of the High Court upon the interpretation of the definition of 'scheme' in Peabody and the dearth of critical consideration of this issue in the Spotless decision, it is difficult to assess how the definition of 'scheme' will be applied in the future. However, the approach of the High Court would seem to be founded upon an understanding of the practical meaning test which emphasises the 'all' in 'robbed of all practical meaning'. This approach to the definition of scheme suggests that the Commissioner may isolate those parts of any business transaction as a scheme which have some 'practical meaning'. On this view, it might be argued that virtually any part of a scheme can be attributed with some meaning, and therefore the apparent limitation upon the Commissioner's power to define a scheme embodied in the requirement of 'practical meaning' belies the breadth of the Commissioner's actual power. Given that the share devaluation had little practical meaning on its own, the Peabody decision therefore suggests that the Commissioner will be able to isolate any part of a scheme as a scheme in itself in almost all circumstances.

5 The Requirement of a Tax Benefit

Section 177C(1) provides a definition of 'tax benefit', requiring either that an amount would have been included in the taxpayer's assessable income, or that a

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87 FCT v Spotless 96 ATC 5201, 5205 (High Court); FCT v Spotless 95 ATC 4775, 4805 (Cooper J, Northrop J concurring).
88 FCT v Spotless 95 ATC 4775, 4805 (Cooper J, Northrop J concurring).

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taxpayer would reasonably be expected to have included an amount in their assessable income, had the scheme not been entered into. Section 177C(2) excludes any tax reduction attributable to the exercise of any choice or election expressly allowed to the taxpayer under the provisions of the Act outside Part IVA. Since the introduction of Part IVA, there had been considerable uncertainty as to how the definition of 'tax benefit' in s 177C was to be interpreted in relation to two matters: the degree of probability required by the words 'would be reasonably likely' and also the interaction of Part IVA with the remainder of the Act.

The first issue regarding the potential scope of s 177C was the meaning to be attributed to the requirement that an assessable receipt would, or 'would reasonably be expected' to have been received by the taxpayer in the absence of the relevant scheme. One interpretation of this definition suggested that the Commissioner could only annihilate the relevant scheme and then, on the basis of the taxpayer's affairs which remained, examine whether the taxpayer would almost definitely have received an assessable amount or not. Such a narrow reading would have been consistent with, for example, the approach to the meaning of 'control' adopted in Keighery, where the High Court interpreted the term in a restrictive fashion. If adopted, this approach would have gone a long way towards resurrecting the annihilation doctrine, which had been perceived as one of the major shortcomings of s 260.

However, an alternative interpretation of s 177C suggested that the words 'reasonably likely' were to be interpreted as merely requiring that the benefit be

89 It should also be noted that arrangements which generated deductions and also those which were designed to minimise withholding tax liability are also specifically included within the concept of tax benefit: Income Tax Assessment Act 1936 (Cth) ss 177C(1)(b), 177CA.
90 DG Hill, 'A New Interpretation of s.260 and its Implications for Part IVA' above n 68, 7. A broad annihilation doctrine had posed particular problems in the case of 'first time' schemes where no antecedent transaction existed, as it would not be possible to establish whether the taxpayer would have received an assessable amount. For further discussion of the annihilation doctrine see the material cited at n 55 above.
a 'remote possibility'. On this view, the Commissioner would have had a broad discretion to reconstruct the taxpayer's affairs in determining whether a tax benefit existed, as the Commissioner could consider numerous remote possibilities after identifying and annihilating the relevant scheme. This interpretation of the provision raised the spectre of a wide ranging administrative discretion which enabled the Commissioner to reconstruct the taxpayer's affairs such that no taxpayer could seek respite in a harbour safe from the scrutiny of the Commissioner. To many this was anathema to the rule of law and contrary to the interests of business taxpayers making well informed business decisions. By contrast to the concerns of many tax advisers and some parts of the business community, to those concerned about the integrity of the tax system and the need to eliminate 'tax avoidance', a broad meaning of the definition of tax benefit was the only course if the income tax was to survive in a viable form.

With respect to the second issue regarding the meaning of s 177C, that provision provided that the only tax concessions free from the potential operation of Part IVA were those under which the taxpayer was expressly allowed a choice or election. The limited nature of this exemption from Part IVA implicitly included within the definition of 'tax benefit' any choices which were only implicitly allowed to the taxpayer under the legislation. At the time of its introduction, the definition of tax benefit was understood to be directed towards the elimination of the broad choice principle adopted in the cases of the Barwick era. Notwithstanding the apparent legislative endeavour to restrict what were portrayed as the excesses of the Barwick court, it was not clear how 'express' a tax concession had to be before it would be excluded from Part IVA. It has already been noted that Part IVA is generally accepted to operate as a parallel

91 DG Hill, 'A New Interpretation of s.260 and its Implications for Part IVA' above n 68, 7.
93 'Tax Avoidance in Australia: Results and Prospects', above n 15.
provision in cognisance of the fact that s 177B(1) states that nothing in the provisions of the Act outside Part IVA was to be understood to limit the operation of Part IVA. On this basis it was possible that a broad reading of the definition of tax benefit in s 177C would overreach a 'sensible' general anti-avoidance rule which paid greater attention to the legislative context of Part IVA. In particular, it would be illogical for the Act to offer certain incentives to taxpayers as a means of encouraging them to make particular business decisions, only to have those investment decisions and the relevant tax incentives overridden by Part IVA. The Treasurer's discussion of the definition of 'tax benefit' in his Second Reading Speech did nothing to allay such concerns on the part of taxpayers. At one point he accepted that arranging one's affairs to attract specific tax concessions would not fall within the ambit of Part IVA, but carried on to observe that Part IVA would apply where the taxpayer 'blatantly misused' such concessions:

I do assert that taxpayers who simply take advantage of concessions for the purposes for which they were put in the law cannot and will not be affected by the new provisions. Specifically, for example, Part IVA will not deny to people who simply respond to our concessions for investment in Australian films the benefit of the tax advantages that are part of those concessions. But I think it incontrovertible that blatant misuse of those and other 'incentive' concessions ought to be within the scope of Part IVA. A general anti-avoidance provision would be of little worth if it could not be used to prevent unintended exploitation of such concessions in the law, or to operate as a backup to a specific anti-avoidance provision in circumstances where a taxpayer has tailored arrangements so that the provision is circumvented in form, but not in substance.

Given that taxpayers will commonly arrange their affairs in order to attract a tax benefit, and given the Treasurer's acknowledgement that Part IVA would apply to some such endeavours on the part of taxpayers to maximise tax concessions,

94 Gustafson, above n 94.
there was legitimate concern that Part IVA would override what a taxpayer had considered to be a legitimate investment decision.\(^9^6\) Thus, for example, a taxpayer choosing to invest in research and development in order to attract the advantageous tax deduction for such expenditure, rather than making non deductible capital expenditure, would worry that Part IVA could be applied to override this choice of investment. While in most cases the taxpayer might have a good case for maintaining that the dominant purpose of the investment decision was not to obtain the tax benefit, being subjected to the seemingly arbitrary inquiry as to the dominant purpose of the taxpayer was an additional concern which many business taxpayers and their advisers felt that they could do without.\(^9^7\) By limiting the scope of s 177C, it was felt that the prospect of Part IVA being applied to everyday commercial transactions would be rendered more remote, freeing legitimate business decisions from the spectre of Part IVA.

On the other hand, to those concerned to eliminate tax avoidance, the definition of ‘tax benefit’ was open to judicial restriction in the same way that s 260 had been limited. After all, the case of *Mullens Investments Pty Ltd v FCT*\(^9^8\) was widely criticised on the basis that it sanctioned blatant tax avoidance, but in his judgment Barwick CJ had stressed that his interpretation was quite consistent with the purpose of the provisions granting the particular tax concession.

6 The Interpretation of s 177C in the High Court

In dealing with the definition of tax benefit, the High Court referred to the decision of one Supreme Court judge upon a matter of company law,\(^9^9\) before once again appearing to reach an uneasy compromise between the rival interpretations of s 177C:

\(^9^6\) Parsons, above n 92, 839.
\(^9^7\) Murphy above n 67, 537.
\(^9^8\) 76 ATC 4288.
\(^9^9\) *Dunn v Shapowloff* [1978] 2 NSWLR 235, 249 (Mahoney J).
A 'reasonable expectation' requires more than a possibility. It involves a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable.\textsuperscript{100}

The High Court therefore apparently rejected an approach which would have given the Commissioner a broad power to reconstruct the taxpayer's affairs, while simultaneously rejecting the annihilation doctrine by allowing the Commissioner to reconstruct the taxpayer's affairs in accordance with what was 'reasonably' expected to happen, as opposed to a certainty, in the absence of the scheme.

It is not apparent from the decision why the decision of a Supreme Court judge upon a criminal prosecution under the Companies Code was considered relevant to the interpretation of a tax avoidance provision, notwithstanding that the anti-avoidance provisions of Part IVA apply with penal effect. There was ample scope to ignore and/or distinguish \textit{Dunn v Shapowloff} on any number of bases, and yet the High Court clutched at this statement of a single judge of a lower court. Even if it is conceded that the definition of 'reasonably expected' offered by Mahoney J in \textit{Dunn v Shapowloff} was relevant to the High Court's deliberations upon this issue, it is axiomatic that the High Court was not bound by his Honour's definition. The absence of any critical consideration of the relevance of \textit{Dunn v Shapowloff}, any consideration of alternative interpretations and of alternative interpretative methodologies is striking in a context where there were such widely differing interpretations of s 177C prior to the High Court decision.

Furthermore, contrary to the generally accepted view that the High Court is now more willing to adopt a substance approach in applying the law to the facts of

\textsuperscript{100} 94 ATC 4663, 4671.
tax cases, the decision in Peabody exposes the formalism of the High Court. Noting that it was not sufficiently predictable that Mrs Peabody would have received the relevant income in the relevant year, the High Court held that she had not received a tax benefit and therefore concluded that Part IVA could not apply. The finding that there was no reasonable expectation that the profits would flow to Mrs Peabody in the relevant year was apparently based upon the view that, in the absence of the devaluation of the Kleinschmidt shares in the hands of Loftway, the timing of the distribution of the profits from the sale of the Kleinschmidt shares was not a matter of reasonable prediction, because any such distribution of profits was at the discretion of the directors of Loftway. Further, the High Court apparently relied upon the fact that the discretion exercised by the trustees of the Peabody trust with respect to the distribution of trust income added an additional level of uncertainty as to the timing and direction of those profits. The clear suggestion is that taxpayers in a position to add additional formal levels between themselves and the ultimate source of income thereby enhance their prospects of escaping the operation of Part IVA. At a time when the High Court is purportedly concerned with the substance of the case, this reluctance to look beyond the formal veil of the taxpayers affairs is remarkable.

The interpretation of s 177C in Peabody therefore reflected the ambivalence of the provision. On the one hand, the High Court accepted that the provision invested the Commissioner with some power to reconstruct the taxpayer's affairs. On the other hand, it restricted this reconstructive power by accepting without question the legal form of the taxpayer's arrangement which pre-existed the scheme. Notwithstanding this ambivalence and the choices which it creates,

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102 Lehmann and Coleman, above n 46, 26.
the High Court presented its interpretation of s 177C as the outcome of an inexorable process - as the one true outcome of the case.

This erasure of plurality is also evident in the second High Court decision upon Part IVA. In Spotless, it will be recalled, the taxpayer had moneys from a public share issue which it had invested on short term loan. The taxpayer considered making tax advantaged investments in either the Cook Islands or in Hong Kong, but opted for the Cook Islands arrangement on the basis that it produced the higher after tax return. The High Court accepted that in this case there was a tax benefit on two grounds. Firstly, that it was reasonably likely that, in the absence of the Cook Islands scheme, the taxpayer would have kept the moneys on short term loan within Australia and thereby derived assessable income. Secondly, on the basis that the taxpayer's reliance upon the specific concessionary provision of s 23(q) did not preclude the application of Part IVA.

With respect to the second issue regarding the interpretation of s 177C, the taxpayer had argued that it would not have derived the same return in Australia as it did from the Cook Islands investment, and therefore that the taxpayer could not reasonably be expected to have included 'that amount' in its assessable income. This argument therefore hinged upon the proposition that s 177C could only apply where the taxpayer chose to derive the identical amount in a way which produced a tax free receipt. On this point the High Court conceded some latitude to the Commissioner, accepting that:

It is sufficient that at least the amount in question might reasonably have been included in the assessable income had the scheme not been entered into or carried out.

In reaching this conclusion, the High Court did not expressly refer to the 'legislative intention' or to the 'literal meaning' of s 177C, preferring instead to

103 96 ATC 5201, 5211.
present its decision in axiomatic fashion. Further, the assumption that the
taxpayer would have kept its monies on short term loan if the tax exempt
arrangement had not proceeded, necessitated a considerable leap of faith which
was not justified by recourse to 'the legislative meaning'. If the taxpayer had
been advised that Part IVA would apply to the Cook Islands arrangement, it
could quite reasonably have considered alternative forms of 'legitimate' short
term investment which could have produced a higher after tax rate of return in
the taxpayer's hands whilst generating a lower level of income. For example,
the taxpayer might have considered share investments with a view to taking
advantage of the intercorporate dividend rebate - the taxpayer might even have
acquired redeemable preference shares under a redeemable preference share
financing arrangement similar to the one entered into in the Peabody case and
which the High Court was prepared to accept was a 'rational commercial'
arrangement.105 Under such arrangements the after tax rate of return on the
dividend income might have exceeded the after tax rate of return derived from
the short term money market because the dividend income would effectively be
free of tax. The High Court in Peabody had apparently accepted that the
existence of discretion as to the timing and flow of money to the taxpayer
precluded the conclusion that the profits would flow to the taxpayer in the
relevant year. However in Spotless the High Court implicitly rejected the
proposition that the existence of discretion in the hands of the taxpayer's board
precluded the finding that the tax benefit would not have been derived.
Although the facts of the cases are quite different, it is not clear from the
Spotless decision why the High Court was prepared to acknowledge the
significance of discretion in the Peabody case and not in the Spotless case.
Strangely, had Spotless Services created a subsidiary in the Cook Islands for the
purposes of the transaction, the decision in Peabody would suggest that the
High Court would have adopted a formalist stance by acknowledging the

104 Ibid.
significance of the subsidiary's discretion with respect to the profit distribution, and accordingly found that Part IVA could not apply because it was not clear when the profits would be repatriated to Australia (in the absence of any firm evidence of an intended repatriation of profits at a particular time).

The preparedness of the High Court to reach conclusions without expressly assessing the competing interpretations from alternative interpretative standpoints is also evident in its decision with respect to the interaction of Part IVA with the specific provisions of the Act, including s 23(q). In the Full Federal Court it was apparent that Cooper J was mindful of this issue. Having noted that s 23(q) was not the only exempting provision in the Act, he implicitly acknowledged that Part IVA would have to be read down if such exempting provisions were to effectively channel investment into government preferred alternatives. The exemption of foreign source income was attributable to the perceived need to avoid double taxation upon foreign source income and a range of other considerations. 106 No matter what the policy justification for the exemption under s 23(q), there was a plausible argument that the taxpayer was quite entitled to take advantage of this incentive expressly allowed for by the Act by investing its surplus funds in the Cook Islands. Of course a broad reading of this choice doctrine might have rendered Part IVA largely ineffective in much the same way that s 260 had been restricted by judicial interpretation. It was precisely for this reason that s 177B(1) provided that the provisions of Part IVA were not to be construed as limited by the other provisions of the Act. The decision of the Full Federal Court in Spotless therefore threatened the viability of Part IVA as an effective check upon tax avoidance.

In concluding that Spotless Services had derived a tax benefit, the High Court did not expressly consider the perceived purpose of Part IVA in the context of

105 94 ATC 4663, 4671.
the legislative scheme of the *Income Tax Assessment Act 1936* (Cth), but it clearly left the way open for the Commissioner to attack taxpayers who structured their affairs in order to fall within an express provision of the Act. The failure of the High Court in this case to explain the interaction of s 177C with the remaining provisions of the Act once again highlights its erasure of interpretative complexity in favour of an appearance of legal determinacy.

7 The Requirement of Dominant Purpose

Section 177D lists the matters to be taken into account in ascertaining the existence of a dominant purpose to obtain a tax benefit for the relevant taxpayer. Adopting the approach suggested in *Newton v FCT*, the legislature had developed an 'objective purpose' test in s 177D which required a host of 'objective' factors to be considered in determining whether 'it would be concluded' that any person carried out any part of the scheme for the purpose of obtaining a tax benefit for the taxpayer. It was not necessary to establish the actual subjective purpose of the relevant person, it was enough to conclude from the objective evidence that such a purpose could reasonably have existed.

The ascertainment of the 'dominant purpose' of the taxpayer under s 177D had also generated considerable debate after the introduction of Part IVA. Perhaps the most significant issue raised in this debate was whether the minimisation of tax by prudent business planning in ordinary business transactions could be characterised as a purpose to obtain a tax benefit, or whether it should merely be characterised as prudent commercial practice. It had been suggested that if

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107 (1958) 98 CLR 1.
109 There had been considerable discussion of this issue in other tax jurisdictions: see, for example, P Faber, 'Business Purpose and Section 355' (1990) 43 *The Tax Lawyer* 855; J van Kempen, 'The Business Purpose Test: The Dutch Approach' (1985) 6 *Fiscal Studies* 66; Spear, *Corporate Business Purpose* in *Reorganisation* (1947) 3 *Tax Law Review* 225; Michaelson, "Business Purpose Test" and Tax Free Reorganization' (1952) 61 *Yale Law Journal* 14;
the taxpayer entered into a transaction which included some degree of tax
minimisation, while nevertheless carrying on a legitimate business activity, s
177D would not be satisfied because the purpose of obtaining a tax benefit
would be overwhelmed by the broad business purpose of the legitimate
enterprise. On this view, the scope of Part IVA would be restricted to a handful
of cases in which taxpayers had engineered one off arrangements which had no
commercial justification whatsoever.

In the Full Federal Court decision in Peabody, it was held that the dominant
purpose of the scheme as defined by the Commissioner was to allow for the
public issue of shares in the Pozzolanic group and the consequent raising of
capital.110 This was considered to be a purely commercial purpose to which s
177D could not apply.111 The silent hand of the business taxpayer rhetoric may
discerned in the Full Federal Court decision, relegating taxation to ‘just
another business expense’ which prudent business people would minimise as far
as possible. The High Court decision in Peabody did not expressly consider the
interpretation of s 177D, as the High Court held that Mrs Peabody had not
obtained a tax benefit. Nevertheless, in accepting that the creation of Loftway
to take advantage of the preference share financing arrangement was a ‘rational
commercial decision’,112 the High Court appeared to lend some credence to the
view that it was prepared to accept that the creation of transactions which had
one aspect of tax minimisation would not be characterised as tax avoidance.113

This business taxpayer rhetoric figured prominently in the Full Federal Court
judgment of Cooper and Northrop JJ in the Spotless litigation. In deciding that
the taxpayer did not have the requisite purpose for Part IVA to apply, Cooper J
(with whom Northrop J concurred) appeared to rely upon a number of factors.

110 93 ATC 4104, 4117-8 (Hill J, Ryan and Cooper JJ agreeing).
111 Ibid.
112 94 ATC 4663, 4671.
A critical facet of the judgment was the proposition that the taxpayer’s purpose in entering into the offshore lending arrangement was merely a rational commercial decision to maximise its after tax profits by minimising its ‘costs’:

When investing outside Australia, the incidence of tax and the operation of any relevant double taxation rate between Australia and the countries in which investment is being considered will be relevant to a decision to invest overseas or not. Where by the operation of the foreign taxation laws and the existing Australian taxation laws the net return after the payment of all applicable tax and other costs of the investment is higher investing offshore than within Australia, it cannot be said that, objectively, the dominant purpose of the investor investing offshore is to get a tax benefit; the purpose is to obtain the maximum return on the money invested after the payment of all applicable costs, including tax.114

From this passage it may be seen that Cooper J accepted that tax was just another business cost which all prudent business people would minimise. Accordingly, he concluded that the arrangement was founded upon a perfectly legitimate commercial purpose, as distinct from a purpose of obtaining a tax benefit. His Honour therefore accepted that s 177D did not apply in the circumstances. Although Cooper J appeared to suggest that the pursuit of such a purpose by artificial or contrived means would fall foul of Part IVA, he stressed that in this case the taxpayer’s transaction involved both in form and substance ‘real’ money and a ‘real’ transaction.115

In the High Court, this business taxpayer rhetoric was rejected on the basis that the juxtaposition of a rational commercial decision and a scheme entered into with the dominant purpose of tax avoidance was a false dichotomy.116 The High Court reasoned that the only reason for investing funds in the Cook Islands at a similar level of security but a lower rate of interest than available in Australia

114 95 ATC 4775, 4812.
115 95 ATC 4775, 4810.
116 96 ATC 5201, 5206.
was to obtain a tax advantage, concluding that this was a scheme to which Part IVA applied. While the majority of the High Court did not expressly refer to any legal authority or legal argument in support of its approach to the interpretation of s 177D, at one point in the majority judgment it is clear that the High Court was swayed by the rhetoric of tax equity and the perceived need to bolster the welfare state from the threat of tax avoidance. Having noted that the US Supreme Court had accepted that tax minimisation was to be expected in the conduct of business, the majority of the High Court carried on to reject the proposition that this meant that tax avoidance by business taxpayers ought to be legitimised:

In Australia, State and Territory stamp duty laws have been a particularly significant factor in the shaping of business transactions. However, the tax laws are one part of the legal order within which commerce is fostered and protected. Another part is Pt IV of the Trade Practices Act 1974 (Cth), which regulates or proscribes certain restrictive trade practices. In this broad sense, "[t]axes are what we pay for civilized society", including the conduct of commerce as an important element of that society.  

In this rather Delphic comment, which was not necessary for the High Court's subsequent elaboration upon the meaning of dominant purpose, the High Court seems to be suggesting that taxpayer's must learn to accept that if they want the protection of the state and the other benefits that the existence of the state brings, they must be prepared to pay their 'fair share'.

However, even from the perspective of fairness, it is arguable that the decision of the High Court in Spotless was unjustified. Members of the public had subscribed for Spotless shares at a time of high interest rates, and also at a time when corporate profits were subject to what the Asprey and RATS Reports had characterised as an inequitable system of corporate taxation under which

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117 Ibid.
corporate profits were subject to tax twice.\textsuperscript{118} Had the subscribers to the shares invested their funds with a bank, they would have received a similar rate of return to that achieved by Spotless with its Cook Islands investment (which attracted a rate of interest 4.5\% lower than the bank bill buying rate in Australia). However, the direct investment of the subscribers in the form of bank deposits would have generated interest which was only taxed upon receipt by the depositors, at worst at a top marginal rate of 57.08\%.\textsuperscript{119} By contrast, if the investment profit derived by Spotless was distributed to its shareholders, that profit would be taxed twice, and could be subject to an effective rate of tax of 70\%.\textsuperscript{120} In this context, it was a perfectly rational decision on the part of the Spotless directors to seek tax exempt investments in order to retain the confidence and support of their shareholders. Further, by applying Part IVA in these circumstances, the Commissioner bolstered what was officially recognised to be an unfair taxation system and contradicted the rhetoric of tax equity upon which Part IVA was purportedly founded.\textsuperscript{121} If taxes are what we pay for a civilised society, it might have been suggested, then the imposition of a liability under what was acknowledged to be an inequitable taxation system, and the imposition of tax avoidance penalties to boot, could hardly be considered to be 'civilised'.


\textsuperscript{119} Income Tax Rates Act 1986 (Cth) s 7(1), Sch 1.

\textsuperscript{120} Note also that even if the profit was not distributed to shareholders but retained by the company, such retained profits would theoretically have inflated the share value which would have been taxed when shareholders (share traders or those that had acquired shares after 20 September 1985) disposed of their shares. For a discussion of the inequity of Part IVA when applied to enforce the double taxation of corporate profits, see: Parsons, above n 48, 100-103.

Conclusion

At the beginning of the 1980’s it was commonly accepted that there had been a fundamental shift in the methodology of statutory interpretation in favour of the discovery and application of the legislative intention. To this day there is considerable support for the intentionalist rhetoric. On the basis of this rhetorical shift, it might have been expected that recourse to the legislative intention would have become a necessary step in confirming or departing from the perceived literal meaning in every case. Further, it might have been expected that such recourse to the legislative intention would have been all the more apparent given what is generally considered to be a greater willingness on the part of the courts to overcome tax avoidance. Given that it is generally accepted that tax avoidance defies definition, and given the wide array of plausible alternative interpretations of the terms of Part IVA published by numerous commentators prior to the Peabody and Spotless litigation, one striking feature of the High Court decisions is the brevity with which the appropriate interpretative methodology was considered. Moreover, it is remarkable in this era of purposive interpretation that in the Peabody and Spotless matters, no judicial decision has expressly relied upon the legislative purpose in supporting an interpretation of the legislation. When recourse to the legislative purpose was raised as a potential aid to the interpretation of the statute, it was apparently dismissed in favour of a literalist rhetoric. Thus only O’Loughlin J at first instance in the Federal Court referred to the possibility that Part IVA might be interpreted by having regard to the legislative purpose evidenced in extrinsic materials, but discounted this approach on the basis that the literal meaning of the words was plain. In Peabody the High Court briefly referred to one understanding of an intentionalist methodology when it commented that Part IVA ‘replaced s 260 which had proved to be somewhat

122 Peabody v FCT (1992) 92 ATC 4585, 4593 (O’Loughlin). See also: Marsh v FCT 85 ATC 4345, 4363; FCT v Bill Wissler (Agencies) Pty Ltd 85 ATC 4626, 4631; Case W58 89 ATC 524; Gray v FCT 89 ATC 4640; Trevisan v FCT 91 ATC 4416, 4422;
ineffective as a measure to counter tax avoidance arrangements'. 123 This passing reference to the perceived need to fashion an ‘effective’ general anti-avoidance provision did not, however, overtly figure in the resolution of any of the substantive issues which the Court was called upon to resolve. By contrast to this faint reference to an intentionalist approach, in Spotless the High Court appeared to adopt a literalist rhetoric, commenting that Part IVA was to be ‘construed and applied according to its terms’. 124 However, when drawing conclusions upon the application of Part IVA to the particular facts of the Spotless matter, the High Court did not expressly rely upon what it considered to be the literal meaning of the provisions.

A review of all tax cases since 1980 suggests that express reliance upon ss 15AA and 15AB of the Acts Interpretation Act 1901 (Cth), or the principles enunciated in Cooper Brookes, is the exception rather than the norm in income tax cases. 125 More commonly, judges have made some passing reference to the perceived intention of a provision, without offering any detailed examination of underlying policy objectives which may be discerned in the legislation and

123 (1994) 94 ATC 4663, 4665.
125 A point made by several authors over the past 20 years: W Leitch, ‘Interpretation and the Interpretation Act 1978’ [1980] Statute Law Review 5; Allerdice, above n 32. In FCT v MacFarlane (1986) 86 ATC 4477, in the Full Federal Court Beaumont J (Fisher J concurring) apparently relied upon the common law mischief rule rather than the Acts Interpretation Act 1901 (see 4492), while in the first instance decision of Cooling v FCT extrinsic material was also relied upon without recourse to those provisions (89 ATC 4731, 4743). See also Grant v DFCT (1986) 66 ALR 690, where the Federal Court referred to the relevant explanatory memorandum to ascertain the legislative purpose. In Hilton v FCT 92 ATC 4534, 4539 Hill J apparently considered that ss 15AA and 15AB of the Acts Interpretation Act 1901 were coextensive with the principles set out in Cooper Brookes; for other decisions purporting to apply s 15AA see: Healey v FCT 89 ATC 4152, 4156; Richardson v FCT 97 ATC 5098, 5112-3 (Merkel J); FCT v Ryan 98 ATC 4428, 4439 (Merkel J). For decisions purporting to apply or be consistent with the application of s 15AB see: CTC Resources NL v FCT 94 ATC 4072, 4076 (Gummow J); ANZ Banking Group v FCT 93 ATC 4238, 4278 (Lockhart J); Hepples v FCT 90 ATC 4497, 4518 (Gummow J); Morris v FCT 89 ATC 5303, 5309 (Hartigan J). For decisions where the judge has preferred a rhetoric of literalism see: FCT v Faywin Investments Pty Ltd 90 ATC 4361, 4379 (Hill J, dissenting); FCT v Knight 83 ATC 4789, 4795 (Sheppard J); FCT v de Vonk 95 ATC 4820, 4822 (Foster J); Shells Self Service v FCT 89 ATC 4233, 4244 (Ryan J).
extrinsic material. Thus, some judgments in the *Peabody* and *Spotless* litigation referred to the legislative purpose of Part IVA in a cursory manner, usually in introducing the terms of Part IVA, but made no further reference to this purpose. In such cases it is difficult to ascertain whether the perceived policy of a particular provision was taken into account by the court, although it must be considered that this is unlikely, given the omission of any express reliance upon the legislative purpose by the respective judges in reaching their conclusions. Furthermore, such references to the legislative intention are little different to the references to legislative intention occasionally made by the courts over the past century. Such references are more of a rhetorical flourish than a detailed discussion of competing policies and the perceived import of the legislative compromise embodied in the legislation.

There has therefore been a pervasive reluctance on the part of the judiciary to overtly contemplate the legislative purpose in weighing competing interpretations of a particular provision of the income tax legislation. This reluctance would be understandable if the legislation had been transformed during the 1980’s, such that the literal meaning was unquestionably clear and mirrored the legislative intent. But it has been argued that the legislation remained open to competing interpretations, and that the legislative intention was anything but clear. The one thing that was clear was that there was considerable debate regarding the scope of the provisions comprising Part IVA prior to the litigation in *Peabody* and *Spotless*.

This judicial intransigence with respect to the adoption of a purposive interpretative methodology might also be explained by the fact that *Cooper Brookes* and the *Acts Interpretation Act 1901* (Cth) ss 15AA and 15AB overrode what was considered to be a longstanding common law principle.

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126 See, for example, *Peabody v FCT* 93 ATC 4104, 4110 (Hill J); *FCT v Peabody* 94 ATC 4663, 4665 (High Court).
requiring the literal interpretation of tax legislation. It might therefore be expected that there would be some judicial reluctance to accept the new purposive approach, as the judges came to terms with the new interpretative methodology. However, this explanation is also unconvincing. Given the outcry against 'pedantic literalism' during the early 1980's, and the strength of the intentionalist rhetoric adopted by several prominent figures in the Australian judiciary, it might have been expected that any such intransigence would have dissipated relatively quickly.

Although the conservatism of the judiciary is not an adequate explanation, in itself, of the failure of the courts to expressly embrace the intentionalist rhetoric, it is part of a more plausible explanation. This explanation focuses upon the proposition that express recourse to the legislative intention is perceived to be an admission of legal pluralism which is anathema to the determinacy thesis. While various intentionalist theories are quite consistent with the determinacy thesis and modern liberal legal theory, the earlier discussion of the ad hoc compromises embodied in the Commonwealth income tax indicates the problematic nature of 'the legislative intention' in the context of the Commonwealth income tax. To embark upon a broad examination of legislative policy is therefore considered to offer little benefit in the context of the income tax legislation, where there is only ad hoc compromise upon ad hoc compromise, apparently defying any attempt to identify a consistent underlying policy of any practical use in ascertaining the determinate legislative meaning. A close examination of legislative intention would require participation in open ended debate which defies the closure which is commonly taken to be the hallmark of 'the law'. Indeed, some have suggested that such legislative ambivalence evidences a legislative intention to effectively delegate the

127 See chapter 4 above.
formulation of underlying principles of taxation to the courts. While some judges have embraced the concept of judicial lawmaking in their extra curial observations, the 'lawmaking' that they envisage is constrained by what is assumed to be a moral consensus within the community. From the discussion of the conflicting discourses influencing the *Income Tax Assessment Act* in chapter four and at the beginning of this chapter, there are good reasons for doubting that there will ever be the moral consensus upon matters of taxation which underpins the judicial theorisation of judicial activism. In practice, then, any overt consideration of the legislative intention of the tax legislation is perceived to be a little too close to the 'dangerous' path of judicial lawmaking.

By contrast, what is often portrayed by both courts and commentators alike as a close reading of the legislation offers the courts the apparent safety of a harbour of certainty, insulating the judges from the perceived vagaries of speculation as to legislative purpose. However, the preceding case studies suggest that the apparent certainty of key legislative terms such as 'scheme', 'tax benefit' and 'purpose' is a mirage. The context in which those terms are to be applied is fundamental to the attribution of meaning in any particular case. The traces of the discourses of the welfare state, business taxpayers and the rule of law may be discerned in any judgment. Although this recognition of the plurality of discourses influencing modern Australian tax interpretation suggests that meaning is dependent upon the context of the text, there is no overt recognition of such a role for the statutory context in the judgments. In both *Peabody* and *Spotless* the High Court handed down its judgments with the certainty of conviction noted in earlier decisions of the High Court. There is, in other words, an erasure of semantic plurality as the courts appear to reason towards the one right answer in accordance with the homogenising discourse of liberal legalism.

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CHAPTER 6 - DETERMINACY, INDETERMINACY AND RHETORIC IN A
PLURALIST WORLD

A Introduction

A central aspect of any liberal legal theory is the proposition that the meaning of a legal rule is determinate from its inception or, at the least, determinate immediately before its application to a particular case.¹ For the purposes of liberal legal theory, determinacy may mean that there is always one right interpretation of a rule; or, at the least, that law consists of a vast bulk of interpretive decisions made ‘automatically’, supplemented by a small residue of uncertain cases where courts must ‘make’ law which accords with communal morality. Without such determinacy, liberal legalists maintain, the separation of the judicial from the legislative power under the rule of law would collapse. Judges would presumably apply rules in accordance with some preferred outcome, politically speaking, rather than merely applying the law in the vast majority of cases.² The linchpin of the liberal determinacy thesis is therefore that there is some standpoint from which true propositions of law may be determined. Whilst not assuring a democratic society, the apparent exclusion of arbitrarily exercised power under the liberal rule of law is understood to be an important step away from the perceived tyranny of the ‘Dark Ages’.³

¹ For a generic theory of liberal legalism see Andrew Altman, Critical Legal Studies: A Liberal Critique (1990) 27. For references to a theory of determinacy in the context of particular liberal legal theories see: HLA Hart, The Concept of Law, Raz and Bulloch (eds) (1994), where Hart argues that meaning is generally conventionally determined from the outset, penumbral cases aside; Lon Fuller, The Morality of Law (rev edn, 1969) ch 2; Ronald Dworkin, Law’s Empire (1986) viii-ix, 76-86, where Dworkin argues that the proper interpretation of legal doctrine provides one right answer which can only be determined at the time of judgment. For a similar argument, devoid of the right answers thesis, see: Neil MacCormick, ‘Reconstruction after Deconstruction’ (1990) 10 Oxford Journal of Legal Studies 539.
² Altman, above n 1, 27.
Perhaps the surest path to the determinacy thesis would be a literal theory of meaning which offers the comforting certainty of a 'slot machine jurisprudence'. Alternatively, the interpretation of legislation according to the legislative intention also seems to offer an attractive theory of legal determinacy - some versions of intentionalism even allowing the meaning of the legislation to be adapted to changing social circumstances. However, from the preceding review of the interpretation of tax legislation over the past three centuries, it must be said that the literalist or intentionalist theories of determinacy are less than convincing. Leaving to one side the interpretation of tax legislation during the eighteenth century, even when the courts purported to adopt a literal and/or purposive interpretation of tax legislation, there are good grounds for arguing that the context in which the legislation was created and applied played a far greater role in the interpretative methodology of the courts than either of these objectivist theories would allow. The meaning of income, profits and gains in Victorian Britain, the meaning of the sufficient distribution requirement in Australia over the period 1915-1980 and the meaning of Part IVA were all much more elusive than the literalist theory of interpretation would suggest. The existence of competing interpretations of all of these provisions meant that it was not possible to identify any one literal meaning of the legislative terms. Further, the eclectic nature of the British and Australian income taxes meant that it was impossible to identify one coherent legislative scheme in the search for the legislative intention. Discussion regarding the ‘literal’ meaning and the legislative intention was therefore inevitably subjectivised by the standpoint of the discussant. Notwithstanding the objectivist rhetoric of the courts and the commentators, the interpretation of tax legislation over the past three centuries

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5 See the text in chapter 1 under the heading 'A purposive construction of tax legislation'.
has been influenced significantly by the context in which that legislation was applied.

As noted in chapter one, the mainstream account of tax interpretation suggests that the literalist interpretation of tax legislation has prevailed for some considerable time. It was also noted that liberal legalists have taken considerable comfort from this account, being reassured that the law had indeed risen above the arbitrary exercises of power characteristic of the Dark Ages. If such liberal legalists were to accept that this literalist theory failed as a descriptive account of tax interpretation over the past three centuries, it would remain open to them to suggest that literalism remains the preferred normative theory of statutory interpretation. Although intentionalist theory is considered to have been consistently applied only since the 1980’s, it was suggested in chapters three, four and five that this account also failed descriptively. Once again, those that subscribe to an intentionalist theory of interpretation might be expected to suggest that, even though it fails as a descriptive theory, it should nevertheless be adopted as a normative theory of statutory interpretation. The purpose of this chapter is therefore twofold. Firstly, to consider the merits of alternative normative theories of legal determinacy. Drawing upon the literature regarding the shortcomings of the various theories of language underpinning alternative theorisations of the determinacy thesis, it will be argued that such normative theories are unconvincing.6 The second purpose of this chapter is to develop a theory of legal indeterminacy which explains the phenomena noted in the preceding chapters. In doing so, it is acknowledged that any theory of legal interpretation must explain why judges have purported to comply with the determinacy theory while in fact exercising considerable discretion in every case.

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6 It should be noted that a detailed analysis of all of the theories of legal determinacy is beyond the scope of this thesis. Accordingly, the shortcomings of some theories of determinacy will be outlined and the relevant literature referred to, before turning to a more detailed account of the stronger, hermeneutic and critical theories of legal determinacy.
B Objectivist Foundations of the Determinacy Thesis

1 Literalist Theories of Legal Determinacy

As noted in chapter one, literalist theories maintain that there is one determinate meaning of any word. This determinate meaning may be determined referentially, formally or conventionally.

(a) Referential and Truth Conditional Theories of Literal Meaning

Prior to the twentieth century, the existence of legal determinacy was rationalised by the assumption that language was an objective means of describing the objective world.\textsuperscript{7} There was no question of polysemicity because language conveyed what was ‘there’. Earlier forms of liberal legalism took this referential theory and maintained that law consisted of an autonomous body of rules which could be objectively applied to a determinate range of factual circumstances.\textsuperscript{8} Although there was the pragmatic undercurrent of dissent,\textsuperscript{9} in the main this referential theory of language spawned the slot machine jurisprudence characterised by epithets such as ‘think things not words’.\textsuperscript{10}

\textsuperscript{7} See, for example: JS Mill, \textit{A System of Logic} (1947) 48-9.
\textsuperscript{9} See, for example: CS Pierce, “How to make our ideas clear” (1878) 12 \textit{The Popular Science Monthly} 276.
For the first decades of the twentieth century, logical atomists and logical positivists modified this referential theory by arguing that ordinary language offered but a partial description of the world because it was recognised that there is not necessarily a sign for every referent. Logical atomists and their positivist descendants therefore set about breaking the code of language by defining the necessary and sufficient conditions for a statement to be true.\(^1\) This search for the truth conditions of an utterance was founded upon the separation of the denotation of the utterance from its connotation, or in Frege's terminology of the reference from the sense of the utterance. However it is now generally accepted that this project can never reach the closure of a complete statement of the truth conditions of an utterance.\(^2\) In particular, such theories have been discredited\(^3\) on the basis that there is not a strict demarcation between the denotation and connotation, or the reference and the sense of an utterance.\(^4\) Once the dualism of sense and reference is collapsed, the meaning of an utterance depends upon its context.\(^5\) As MacIntyre observes, the geographical placenames of 'Londonderry' and 'Coire Columcille' refer to the same place, but the sense of the two names is different given the historical and political sense of using either the English or the Irish name.\(^6\) While it might be argued that both names for the same place have the same meaning because they name the same place, this proposition is only true if it is accepted that the

\(^1\) For the classic statement of logical atomism see: L Wittgenstein, (transl CK Ogden), *Tractatus Logico-philosophicus* (1990); this was subsequently adapted by logical positivists such as AJ Ayers, *Language Truth and Logic* (1971).


\(^3\) For a discussion of formal theories of meaning in the context of his attempt to assimilate them with some pragmatic elements, see: J Habermas, 'A Reply' in *Communicative Action*, A Honneth and H Joas (eds) (1991) 234ff.

\(^4\) Gottlob Frege, 'On Sense and Reference', in Max Black and PT Geach (eds) *Translations from the Philosophical Writings of Gottlob Frege* (1952), 56-78; for discussion of this see: Christopher Norris, 'Sense, Reference and Logic' in *The Contest of Faculties* (1985) 47-68.

function of language is to name objects in the world. It is because this ‘naming’ concept of language is considered under-inclusive of the function and effect of language that it has largely been rejected. Accordingly, theories of literal meaning founded upon referentialism or truth conditional theories have therefore generally fallen out of vogue in favour of alternative theories of meaning.

(b) Formalist Theories of Literal Meaning

An alternative foundation for a literal theory of interpretation is formalism. Ferdinand de Saussure\textsuperscript{17} is generally attributed with developing this alternative source of interpretive determinacy by focusing upon \textit{langue} rather than \textit{parole},\textsuperscript{18} thereby emphasising the formal aspects of language as a system of signifiers.\textsuperscript{19} Saussure argued that the meaning of a sign does not depend upon it referring to any aspect of the material world. Rather, he argued, the meaning of each signifier is formally determined by its relationship to all other signifiers within the particular language.\textsuperscript{20} Thus, the signifier ‘cat’ is differentiated from ‘cap’, ‘cad’, ‘dog’ and so forth, and ‘cat’ is arbitrarily assigned the function of conveying the idea of a fluffy thing which commonly purrs and meows. A message consisting of signifiers could be sent and be decoded by the recipient, provided that the appropriate communicative methods were adopted.

The height of twentieth century formalism was reached when structuralists adapted Saussure’s work by locating humanity within a complex array of contingent social structures, not all of which are necessarily apparent to the social actors.\textsuperscript{21} Born into a particular lifeworld organised by such structures, they argued, our perceptions of the world are determined by those structures.

\textsuperscript{17} F de Saussure, C Bally and A Sechehaye (eds), \textit{Course in General Linguistics} (1966) 67ff.
\textsuperscript{18} ‘Langue’ being the system of signs as distinct from parole which is the usage of the signs.
\textsuperscript{19} Saussure, above n 17, 9.
\textsuperscript{20} Ibid, 114ff.
On this view, determinacy was assured because the language system was a self maintaining system in which the meaning of each signifier was capable of objective analysis,\(^{22}\) at the least by an appropriately qualified person.\(^ {23}\) But this structuralist perception that language determines our understanding of the world was criticised for several reasons.\(^ {24}\) One problem was the apparent assumption that language systems came into existence with a 'big bang' - structuralists simply seemed to be willing to assume the existence of some timeless underlying system of signifiers. Objection was also taken to the assumption by structuralists that systemic response to social change in the use of signifiers would quickly achieve a new equilibrium within the one communal language - there was simply no room for a theory of multiculturalism which acknowledged the prospect of multiple discourses. Furthermore, it has been argued that structuralism fails to explain the perceived slippage of meaning in daily discourse. Just as Saussure had excluded consideration of *parole* in favour of *langue*, structuralists excluded consideration of context and the response of the recipient in order to 'scientise' the study of language as an objectifiable system.\(^ {25}\)

(c) A Conventionalist Theory of Literal Meaning

But at least since the later work of Wittgenstein,\(^ {26}\) it has been widely accepted that meaning is pragmatically created rather than being formally determined.\(^ {27}\)

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\(^{22}\) Ibid, 75.

\(^{23}\) For a discussion of this aspect of structuralist theory, see: Christopher Norris, *Deconstruction: Theory and Practice* (revised edn, 1993) 5-6.

\(^{24}\) Eagleton, above n 12, 113.


\(^{27}\) Although, of course, predominantly formal theories of language such as structuralism have, and retain, some prominence in literary theory. For general discussion of literary theory, see the material referred to above at n 12. For an overview of the transition from formalism to
It is therefore understandable that contemporary liberal theories of law develop theories of legal determinacy which accommodate this sea change towards pragmatic theories of language.\textsuperscript{28} This recognition of the pragmatic aspects of language use, accelerated by Wittgenstein\textsuperscript{29} and the contribution of speech act theorists such as JL Austin,\textsuperscript{30} has been developed in various ways. One path has lead to the potentially nihilistic theory of deconstruction.\textsuperscript{31} However, the reception of pragmatism into theories of meaning need not necessarily lead to a theory of indeterminacy. Indeed, the thrust of ordinary language philosophy was to find the source of meaning in the general agreement of a community upon the meaning of terms.\textsuperscript{32}

In the legal context, ordinary language theory was applied most notably by HLA Hart.\textsuperscript{33} In an attempt to overcome the contingency of pragmatically determined meaning depicted by rule sceptics such as Karl Llewellyn,\textsuperscript{34} Hart argued that the application of words to factual circumstances was generally determined by

\textsuperscript{28} Thus, for example, Unger was seemingly compelled by this recasting of liberal theory to recast a definition of legal formalism which accommodated this admission of some versions of pragmatic language theory; see: Roberto Unger, \textit{The Critical Legal Studies Movement} (1986) 1.

\textsuperscript{29} 'For a large class of cases - though not for all in which we employ the word 'meaning' it can be defined thus: the meaning of a word is its use in the language.' Wittgenstein, \textit{Philosophical Investigations}, above n 26, sec 43. Note JL Austin's criticism of 'use' as hopelessly ambiguous; JL Austin, \textit{How To Do Things with Words}, JO Urmson and M Sbisa (eds), (2nd edn, 1976) 100.

\textsuperscript{31} Note the debate as to just what deconstruction means. To Christopher Norris deconstruction is a powerful tool in revealing often subtle rhetorical devices - see, for example: \textit{Deconstruction: Theory and Practice}, (revised edn, 1993) ch 1. On the other hand, Richard Rorty considers that deconstruction authorises the textual solipsism which Derrida has gone some way towards rebutting, at least in his more recent work; see: Richard Rorty, \textit{Consequences of Pragmatism} (1982) ch 6; Jacques Derrida, \textit{Specters of Marx}, Peggy Kamuf (trans), Routledge, (1994) 59. For a scathing attack upon Derrida's duplicity in positing deconstruction while at the same time offering the 'right' reading of Paul de Mann's wartime writings sympathetic to Nazism see: R Wolin, \textit{Labyrinths} (1995) 1-12.


\textsuperscript{33} Although note that it was a modified ordinary language theory which incorporated the permanence of core meanings with the pragmatism of Wittgenstein's agreements upon language.
social convention. According to Hart, by a unidirectional process of incremental growth which excluded the regression of meaning, a ‘dictionary’ of core meanings had been generated. Incorporating the intentionalism of speech act theory, Hart accepted that such core meanings were the primary resource to which a legislator referred in framing legislation. Indeed, at one point Hart suggested that legislative omniscience, combined with this complex of conventionally determined meanings, would mean that legislation might only apply to those circumstances specifically contemplated by the legislature.

Hart’s work can be interpreted in a number of ways, but perhaps the most commonly accepted is the view that for any legal rule there is a large core of determinate meaning supplemented by a penumbral zone of uncertainty where judges must legislate. Under this theory of meaning, the function of the judge is merely to create a list of conventionally determined ‘meanings’, and determine whether the circumstances of the instant case fall within those meanings. Thus, Hart observed, for the purposes of the rule ‘No vehicles in the Park’, the paradigm cases of ‘vehicle’ will be conventionally determined and at present include ‘the motor-car, the bus, the motor-cycle.’ When such

34 K Llewellyn, The bramble bush: or our law and its study (1951); K Llewellyn, Jurisprudence: realism in theory and practice (1962).
35 Hart, above n 1, 126.
36 Ibid, 135; see also 129; but cf Waluchow, Inclusive Legal Positivism (1994) 65.
37 Hart, above n 1, 127-8; he carried on to note that we are merely human and must therefore accept that there will always be a penumbra of doubt beyond the core of meaning, at 128.
40 Hart, above n 1, 129.
conventional meaning 'runs out', he suggested that judges either adopt a purposive interpretation or reach an 'acceptable' decision.

Whilst many critics have attempted to rebut Hart's theory of core meanings by citing such exceptional cases as Fuller's query of whether a book might be a vehicle (of ideas) or Hutchinson's Ford carpark, these attempted rebuttals have merely reinforced Hart's depiction of incremental growth from a determinate core. That is, these exceptional cases can always be rationalised on the basis that they are merely another example of a penumbral case. There is therefore little rhetorical benefit to be gained by challenging Hart's theory of core meanings by pointing to an unusual case. No matter how many reported decisions are cited in support of the indeterminacy thesis, Hart's supporters could always say 'Ah, that is just another penumbral decision which is at the tip of the iceberg - what about the millions of easy decisions made everyday which are not reported simply because there is no argument about the meaning of the terms?'

A more substantial criticism of Hart's conventionalism is that, notwithstanding his view to the contrary, an existing conventional meaning cannot be directly applied to a new case. Even if one accepts the conventional accretion to meaning, no two situations will be identical in every respect. It is therefore necessary to decide whether the instant case falls within the conventionally determined scope of a particular rule, no matter how many cases have previously been considered to fall under the rule. Given the singularity of any case, the application of language in any case must therefore always be what Hart called a 'hard' or 'penumbral' decision requiring the exercise of judicial

41 Hart, above n 1, 127, 129. Note that Hart is indecisive as to whether it is the purpose of the legislature (127) or the purpose of the interpretive community (129).
42 Ibid, 204-5.
43 Hutchinson, above n 39, 811.
44 For a discussion of this aspect see: Burton, above n 38.
discretion.\textsuperscript{46} What is portrayed as the ‘automatic’ application of literal meaning therefore belies the existence of choice in every case.

A second more compelling criticism of conventionalist theories of literal meaning is that they assume that a statutory word cannot have two inconsistent meanings at any one point in time. Inconsistent conventional meanings may arise where different sub-communities attribute a particular meaning to a word which is not generally adopted. The legal subcommunity might, for example, give a word a technical legal meaning different from the ordinary meaning of the term. Such a case causes no concern to a positivist such as Hart, who would have merely accepted that the courts had created a rule that the legislature intended the technical legal meaning to prevail. However, where there are other sub-communities, such as the accounting profession, which develop their own meanings for particular terms, the courts have not adopted any hard and fast tiebreaker rule for determining which meaning ought prevail. Thus, in the case of the income tax in Victorian England it was shown in chapter four that there were a multiplicity of conventional meanings of the terms ‘profits and gains’, and the courts were compelled to choose between the competing meanings.

Regardless of what may be considered the functionalist appeal of conventionalist theories of meaning,\textsuperscript{47} they are therefore unconvincing. Referential, formal and conventionalist literalist theories of legal determinacy therefore fail on both descriptive and normative grounds because the ‘literal’ meaning of any statutory text does not, and cannot, exist. A literal meaning

\textsuperscript{46} Hart, above n 1, 135; see also 129; but cf Waluchow, above n 36, 65. For further consideration of the polysemy of language and its impact upon Hart’s core meanings see: M Wood, ‘Rule, Rules and Law’, in The Jurisprudence of Orthodoxy: Queen’s University Essays on H.L.A. Hart, Leith and Ingram (eds), (1988) 27.
cannot exist because the context in which an utterance is made and interpreted inevitably influences the attribution of meaning.

2 Intentionalist Theories of Legal Determinacy

In the quest for determinacy some language theorists suggested that authorial intention was another aspect, and 'not just one among others', of the context of a particular utterance. Thus, under Austin's speech act theory, authorial intention was fundamental to determining the 'sense' in which a particular speech act was to be understood. A 'valid' or, to use Austin's terminology, 'felicitous' or 'happy' performative utterance required the author to intend the act, use appropriate forms and make the speech act in the appropriate context.

The assumption in this theory of speech acts is that the author has an intention which he or she frames in terms of language and sends the encoded message to the recipient who deciphers it to produce what is hopefully the same concept to that originally thought of by the author. In any particular context, the meaning will be determined by the author's intention even if the mode of expression is 'unhappy'. Although Austin ultimately recognised that his categorisation of speech acts into performatives and constatives was flawed, the importance of authorial intention in determining the meaning of speech acts became a

49 This inclusion of authorial intention under the pragmatic domain contrasts with Moore's suggestion that authorial intention is just another brand of formalism because it purportedly produces one answer; Moore, above n 8.
50 For a discussion of speech act theory see: V Volosinov, Marxism and the Philosophy of Language, L Matejka and I Titunik (transl), (1973); Jurgen Habermas, Communication and the Evolution of Society (1979) ch 1; Passmore, A Hundred Years of Philosophy, above n 12, ch 18; Goodrich, above n 4, 48ff; J Derrida, 'Signature Event Context', above n 48; for a response to Derrida see: J Searle, 'Reiterating the Differences' (1977) 1 Glyph 198. For Derrida's rejoinder see: Jacques Derrida, 'Limited Inc abc' (1977) 2 Glyph 162.
51 Austin, above n 29, 99.
52 Ibid, 14ff.
significant aspect of theories of meaning, and was subsequently developed by Hirsch.  

Indeed, much of the rhetorical force of Hart’s theory of meaning is arguably attributable to his incorporation of literalism and intentionalism within his theory of meaning. In chapter five the general acceptance by lawyers of this accommodation of literalism and intentionalism within the one theory of meaning was noted. Perhaps the most obvious example of this point may be seen in *Cooper Brookes (Wollongong) Pty Ltd v FCT*, where Mason and Wilson JJ accepted that the literal meaning of statutory terms may be overridden after consideration of the legislative intention. At the core of this reconsideration of interpretative theory by the courts is the proposition that the author’s intention can differ from the conventionally determined meaning(s) of the words used. This proposition is generally justified on the basis that language is an imperfect medium for communicating our intention. This highlights a critical assumption of intentionalists - they assume that it is possible to intend something in prelinguistic form such that there can be a difference between the author’s intention and their words. There is, as Derrida suggests, a myth of prelinguistic origins in the intentionalist approach which is unsustainable. On the basis of this assumption, intentionalists embark upon an

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56 It has been argued elsewhere that this attempted reconciliation of two quite different theories of meaning enhanced the rhetorical appeal of Hart’s work but simultaneously comprised a fatal internal contradiction; Burton, above n 38.
57 (1981) 147 CLR 144.
58 See, for example: R Unger, *Knowledge and Politics* (1975) 93. For a similar shortcoming in literary theory see the intentionalist approach of ED Hirsch, above n 55, 82. Hirsch’s approach to literary interpretation was criticised by Stanley Fish in *Is there a text in this class?* (1980) ch 14-15.
59 Hirsch, for example, suggests that verbal meaning should be defined as ‘whatever someone has willed to convey by a particular sequence of linguistic signs and which can be conveyed (shared) by means of those linguistic signs.’ above n 55, 31.
60 See particularly, Derrida, above n 15: ‘I would wish rather to suggest that the alleged derivativeness of writing, however real and massive, was possible only on one condition: that the ‘original’, ‘natural’, etc. language had never existed, never been intact and untouched by writing, that it had itself always been a writing.’ 56.
inquiry to determine what the legislature ‘really meant’. However, the assumption of prelinguistic origins precludes the identification of a methodology by which we can test the accuracy of a particular reading against the author’s prelinguistic intention.\(^{61}\) No amount of extrinsic writing will be determinative of the authorial intention because all such material is necessarily only an imperfect reflection of the prelinguistic intention. Moreover, whilst it is true that communication cannot take place without the ‘formal necessity’ of the author’s intentional act, in itself this does not justify the assumption that the author must be the specifier of meaning in the domain of literature generally.\(^{62}\)

If it is accepted that authorial intention can be pre-lingual, it is not clear how an interpreter can access such an intention in any manner which produces the determinate result sought by liberals. On the other hand, if it is accepted that authorial intention cannot be pre-lingual, an intentionalist must offer a theory of how the terms in which the intention is expressed are to be understood if the intentionalist theory is to be of any assistance. An intentionalist theory by itself is therefore of no assistance in applying a rule to each unique case - it can only exist as part of a broader theory of meaning.

In the legal domain, it might be suggested that there are good reasons, grounded upon modern democratic institutions, for bowing to the assumption of

\(^{61}\) Hirsch acknowledges that such a test is impossible: Hirsch, above n 55, 173.  
\(^{62}\) Hirsch, above n 55, 225-6. Wittgenstein, *Philosophical Investigations*, above n 26, para 33; argued for a dialectical interaction between subject and the object language which envisages language as a diachronic social process; see also the structuralist approach beginning with Saussure who emphasised the all enveloping nature of the system of language which depicts language as a synchronic social system. For a discussion of these aspects of language theory see: Goodrich, above n 4, ch 2; the assumption that meaning can pre-exist language is inconsistent with the widely accepted view that it is language which pre-exists and shapes our experience see: Eagleton, above n 12, 60, 67-71; R Rorty, ‘Indeterminacy of Translation and of Truth’ (1972) 23 *Synthese* 448, 461 n 20; Volosinov above n 50; Jacques Derrida, *Speech and Phenomena* (1973). For a critique of interpretation according to authorial intention on this basis see: H Gadamer, (eds), *Truth and Method*, G Barrett and J Cumming (eds) (1975) 148-9; Jurgen Habermas, *Theory of Communicative Action*, T McCarthy (trans), (1984), vol 1, 275. By ‘specifier of meaning’ I mean the person from whose perspective alone meaning is to be determined.
legislative omniscience in accepting that the legislative intention ought be
determinative. The advantage of this approach is that it enables a theory of
legislation which accepts that the legal meaning which governs us all is fixed by
the democratically elected representatives. However, there are also good
reasons for rejecting the proposition that the legislative intention ought be the
specifier of statutory meaning. One key ground for adopting this view is the
discourse of the rule of law - the subjects are entitled to have ready access to
information regarding the scope of the legal rules governing their behaviour. To
accept that the legislation may say one thing and mean another is anathema to
this standpoint. The point for present purposes is that neither view is
necessarily right - the 'answer' being determined by the weight attributed to the
ideals of democratic representation on the one hand and the rule of law on the
other. The proposition that the legislative intention is legitimately determinative
of statutory meaning need not necessarily be accepted.

Other perceived shortcomings of purposive theory in the context of legislation
stem from the descriptive aspects of intentionalist theory. One key aspect of
intentionalist theory is the preparedness to assume that there is one univocal
'author' of a statute. Is the 'author' the government of the day? Those that
voted for the bill? The originator of the bill? The parliamentary draftsperson?
The person who drafted the instructions for the draftsperson? Interest groups
who have had a substantial input into the final bill? Any of these represent a
relatively limited pool of potential authors when compared with a bill which has
been subjected to substantial public debate before being passed by Parliament.
If a bill has been subjected to widespread public debate it might be argued that
the 'authors', at the least, include those who had made public comment with
respect to the bill. In any case, the recognition of the fact that legislation is born
of a relatively large number of minds makes the identification of the one
legislative purpose particularly problematic. Dworkin has noted the artificiality
of ascertaining the legislative ‘purpose’ in a Parliament of hundreds of members who will vote for legislation for a host of reasons. Some members might agree with what they believe the legislation will achieve, others might agree with the bill for strategic purposes, while others might disagree but vote along party lines? In this context the concept of the legislative intention is a flight of fancy inspired by wishful thinking.

A further difficulty with a purposive theory is that legislation will rarely, if ever, be enacted to achieve just one purpose. In the discussion of the Australian income tax, for example, it was noted that legislation is far more likely to represent a compromise between competing conceptions of the good. It is in identifying the compromise between these often conflicting purposes that courts will have to weigh a range of purposes underlying the legislation. Once it is accepted that the legislative compromise is only imperfectly expressed in the legislative text, as an intentionalist suggests, it is not clear why recourse to further contextual material will necessarily produce a closure in legislative meaning. Taking the Commonwealth income tax legislation, for example, the structuring of such legislation is the result of a balancing of a number of broad imperatives. Such imperatives include the need to raise public revenue, wealth redistribution, fostering business investment, minimising compliance costs and achieving enforceable legislative outcomes. Moreover, as Radin notes, it could be said that a purpose underlying all legislation is to ensure the stability of the political system. Recognising the existence of such purposes does not assist the interpreter in identifying just one ‘meaning’ of the legislative compromise. At best, the interpreter can consider the various discourses underlying the legislation in examining the various consequences of alternative interpretations, but this does not lead the interpreter to one determinate meaning. The point is

63 Dworkin, above n 1, 318-20.
64 Ibid, ch 9; see also: Moore, above n 8, 248ff.
that the examination of legislative purpose inevitably compels the interpreter to make a choice between more or less desirable outcomes.

A theory of determinate legal meaning founded upon legislative purpose is therefore problematic. 66

C Ontology and Determinacy - The Creation of 'Community'

Owing to the growing acceptance of the perceived shortcomings of conventionalist and intentionalist theories of meaning, the objectification of meaning has increasingly been called into question. Modern liberal legal theory has therefore turned, in various ways, towards a hermeneutic standpoint, which acknowledges the impossibility of both literal and purposive theories of meaning. This alternative theory of determinacy was faintly raised by Hart at several points in his discussion of adjudication in penumbral cases. At some points he suggested that judges resolve penumbral decisions in an 'acceptable' way, the concept of 'acceptability' being founded upon Wittgenstein's view that meaning is grounded upon communal consensus. Thus, according to Hart, penumbral cases will be determined by judges who select new meanings to which the wider community gives their 'agreement'. 67 This theorisation of what Hart described as 'judicial lawmaking' signalled a fundamental shift in the liberal conception of legal determinacy. Rather than the content of legal rules being fixed once and for all at the inception of the rule, in accordance with the dictates of prospective determinacy, this non-conventionalist theory acknowledges that the content of legal rules may expand and/or contract over

66 For a discussion of the problems associated with intentionalist theories of interpretation see: Burton, above n 38.
67 Hart, above n 1, 123-4.
time. This alternative form of pragmatic interpretive theory, only hinted at by Hart, was subsequently considered at much greater length by Dworkin.

Pointing to the fact that judges in hard cases speak in terms of determinacy rather than discretion, Dworkin noted that such statements contradicted Hart’s theory that judges make law in every hard case. As we have no reason to believe that judges are simpletons or liars, Dworkin argued, we should take their statements at face value and accept the existence of legal determinacy. Dworkin argued that if the application of the rule is to be determinate at all, the interpreter must link all previous cases under a coherent theory of the application of the rule. A critical aspect of Dworkin’s theory is that he maintained that such a theory cannot help but be a moral theory, as it must draw upon the community’s principles of morality, not only in determining what counts as a theory, but also in establishing the content of such a theory.

Despite the fact that interpretation entails such recourse to communal principles of morality found within institutionally authorised texts, Dworkin argued, there can only be one right interpretation of the relevant legal text at any particular time. This is because an interpreter is constrained to interpret the legal text in light of the best interpretation of a univocal communal morality. According to

68 As opposed to Hart’s conventionalism, where the content of legal rules could only expand as the rules were applied to new circumstances; Hart, above n 1, 129, 135.
69 Dworkin, above n 1, 41-3.
70 Ibid, 37-44. The argument that what you see is what you get is hardly convincing. Everyday people act and speak in accordance with beliefs which do not necessarily make those beliefs true in some universal sense. As Hoy notes, Dworkin’s methodological premise of accepting at face value what judges say may undermine his later argument - that judges must interpret earlier legal texts ‘in their best light’. There is no widely accepted judicial support for this premise; see: David Hoy, ‘Dworkin’s Constructive Optimism vs Deconstructive Legal Nihilism’ (1987) 6 Law and Philosophy 321.
71 Dworkin, above n 1, 42-3.
72 Ibid, vii-ix, 76-86; the assimilation of law and morality along with the right answers thesis would seem counter-intuitive, as Fish notes in Stanley Fish, There’s No Such Thing as Free Speech and it’s a good thing too (1994) 142. For an attempt to construct a pluralist hermeneutic theory see: David Hoy’s contributions in D Couzens Hoy and T McCarthy, Critical Theory (1994); see also: Georgia Warnke, Justice and Interpretation (1992). Warnke even interprets Dworkin as rejecting the right answers thesis, at 71.
such a theory, for example, at one point in time it might be determined that the best interpretation of Hart’s hypothetical ‘no vehicles in the park’ rule indicates that it is highly relevant that the vehicle is being used to rescue an injured person or animal. At another point in time, the best interpretation of the rule in light of prevailing moral norms might hold that both people and animals are expendable and that it therefore makes no difference whether the vehicle is being used to rescue a person or an animal. Under Dworkin’s theory, legal meaning is therefore simultaneously determinate and pragmatic. Legal meaning is determinate because at any point in time there is just one right answer. However, legal meaning is also pragmatic in the sense that the substantive norms of communal morality are constantly being reviewed and rebalanced in the context of a moral scheme which is retrospectively determinate.\textsuperscript{73} Dworkin’s legal hermeneutics therefore portrays the judge as constrained by the moral principle of integrity, while simultaneously contributing to the ongoing development of communal morality in a process of creative construction analogised to writing a new chapter in the legal ‘chain novel’.

In more recent times the influence of Dworkin’s work upon Australian jurisprudence is evidenced by a number of articles published by serving and retired judges.\textsuperscript{74} These judges have acknowledged that judges ‘make law’, but maintain that the law is nevertheless made in accordance with the dictates of communal morality. In the more recent Australian tax jurisprudence implicitly adopting this theory of law, there has been little critical discussion of the extent to which communal morality offers any effective constraint upon judicial lawmaking. At this point it is therefore appropriate to turn to a critical appraisal of Dworkin’s theory of legal determinacy, because his work offers a sophisticated theorisation of legal determinacy founded upon the dictates of communal morality.

\textsuperscript{73} See the definition of this term in chapter 1 under the heading ‘Taxation and the Liberal State’.
\textsuperscript{74} See the material referred to in chapter 1, n 50.
The sophistication of Dworkin’s unification of law with morality and of determinacy with pragmatism, owes much to his interpretation of Gadamer’s hermeneutic theory. However, in *Law’s Empire* Dworkin merely suggests that Gadamer ‘strikes the right note,’ including Gadamer’s hermeneutic theory of meaning by reference without elaborating upon Gadamerian theory or the criticisms thereof. To embark upon a critique of Dworkin’s theory therefore necessitates an appraisal of Gadamer’s theory. As Dworkin’s application of Gadamer’s work has only rarely been considered in any detail, a critical review of Gadamer’s theory must be undertaken in developing a critique of Dworkin’s theory of legal determinacy.

1 An Overview of Gadamerian Hermeneutics

Seeking an answer to the question ‘how is understanding possible?’ Gadamer repositioned the knowing subject of Enlightenment epistemology by adapting Heidegger’s phenomenology. Accordingly, Gadamer argued that the knowing subject was a part of Being as opposed to the dispassionate observer idealised in the commonly held perception of the natural sciences. Moreover, in adopting Heidegger’s concept of the ‘forestructure’ and renaming it ‘prejudice,’ Gadamer argued that ‘the fundamental prejudice of the enlightenment is the prejudice

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75 Dworkin, above n 1, 62.
76 Curiously, although Dworkin referred to both Gadamer and Habermas, he did not consider the criticisms of Gadamer’s theory by Habermas in the course of their exchange. It is therefore surprising to find that Dworkin just assumes that Gadamer is ‘about right’ without considering the merits of the criticisms of Gadamerian hermeneutics in any detail, particularly those found in Habermas’s debate with Gadamer; see: J Habermas, ‘A Review of Gadamer’s *Truth and Method*’ in *Understanding and Social Inquiry*, F Dallmayr and T McCarthy (eds) (1977). For Gadamer’s rejoinder to Habermas see: Hans-Georg Gadamer, *Philosophical Hermeneutics*, D Linge (trans and ed) (1976).
77 Georgia Warnke, above n 72; David Couzens Hoy, above n 70, 327-32.
78 Gadamer, above n 62, xviii; it must be stressed that Gadamer is concerned merely to explain the conditions for understanding and is not concerned with developing a methodology of interpretation by which understanding may occur, a point which he repeatedly states; see for example, 263.
79 Kant aspired to the standpoint of the universal man, depicted in Immanuel Kant, *The Critique of Judgement*, James Meredith (trans), (1952) para 40.
against prejudice itself which deprives tradition of its power. Gadamer continued, constrains our appreciation of the concept of understanding by focusing upon knowing 'the truth', when in fact our prejudices preclude the possibility of ever accessing such objective truth. Instead of offering accounts of the conditions of possibility of such truth, Gadamer argued, philosophy ought to recognise that all understanding is hermeneutic. Hermeneutics is the study of being, and as 'being that can be understood is language,' Gadamer's theory of understanding is founded upon his theory of language.

Acknowledging the social aspect of language and its material foundations, Gadamer therefore rejected referential theories of language. Further, he observed that the process of interpretation is not the excavation of historical fact portrayed by Dilthey or Hirsch, the latter of whom maintained that interpretation entails the reconstruction of the author's subjective intention. Such referential and intentionalist theories of interpretation, Gadamer argued, suffer from the Enlightenment prejudice against prejudice. Developing an understanding of a text, Gadamer continued, is rather an intersubjective process.

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80 Gadamer, above n 62, 239-240.
81 Ibid, 246. Note that Gadamer adhered to the historical specificity of the concept of reason when he observed that 'reason exists for us only in concrete, historical terms, ie it is not its own master but remains constantly dependent on the given circumstances in which it operates.' 245; Gadamer, Wahrheit in den Geisteswissenschaften' in Kleine Schriften, vol 1, 42 quoted in Georgia Warnke, Gadamer: Hermeneutics, Tradition, Reason (1987) 66.
82 Gadamer, above n 62, xxii; for further endorsement of this inheritance from German idealism see; 'Not only is the world "world" only in so far as it comes into language, but language, too, has its real being only in the fact that the world is re-presented within it. Thus the original humanity of language means at the same time the fundamental linguistic quality of man's being-in-the-world.' ibid, 401.
83 Gadamer, above n 62, 446-7; Gadamer, above n 76, 16-17. For discussion of this aspect of Gadamer's theory see: S Hekman, Hermeneutics and the Sociology of Knowledge (1986) 95.
84 Gadamer, above n 62, 260.
85 Ibid, 404-5.
87 Hirsch, above n 55, 82.
88 See the discussion of intentionalist approaches in Gadamer, above n 62, 264.
where the subject encounters an utterance within the context of a social lifeworld which influences its meaning:

It is not only that historical tradition and the natural order of life constitute the unity of the world in which we live as men; the way that we experience one another, the way that we experience historical traditions, the way that we experience the natural givenness of our existence and of our world, constitutes a truly hermeneutic universe, in which we are not imprisoned, as if behind insurmountable barriers, but to which we are opened. 89

Prejudices are therefore positive phenomena, as they enable the interpreter to understand a text. 90 Despite his apparently relativist celebration of prejudice, Gadamer also whiggishly heralded the advance of understanding towards the ‘right’ understanding of the tradition.

The ‘true’ prejudices of the tradition play an important role in influencing (but not determining) the world view of the subject which Gadamer called the ‘horizon’. The horizon is defined as ‘the range of vision that includes everything that can be seen from a particular vantage point’. 91 Different horizons will appear to subjects as they travel along the path of self-knowledge towards understanding, a journey which necessitates the continuous examination of their personal prejudices. A subject will be compelled to examine personal prejudices because there will always be a question posed by the text under examination. 92 Understanding a text therefore entails a confrontation between the reader and the text which causes the reader to critically examine background prejudices with the object of finding a ‘common language’ with the text. 93 Such a confrontation is facilitated by the making of two key assumptions. These assumptions are, firstly, that the relevant text is

89 Ibid, xiv.
90 Ibid, 261-4.
91 Ibid, 269.
93 Ibid, 110; see also: Gadamer, above n 62, 238, 260.
coherent,\textsuperscript{94} and, secondly, that the text offers, at the least, the possibility of some complete truth.\textsuperscript{95} Adopting these assumptions means that the interpreter is compelled to take the text, and more importantly, the different horizon represented by the otherness of the text, seriously.\textsuperscript{96} This insight is what Gadamer called 'effective historical consciousness'.\textsuperscript{97}

By the very process of interpretation, then, the subject will be forced to confront the competing horizons of the text and the tradition. The outcome of this confrontation, Gadamer maintains, cannot be the perpetuation of idiosyncratic interpretations or interpretations which merely replicate the interpreter's prejudices, because the conflict between text and subject horizon will engender a new understanding. Understanding can only be achieved when the horizons of the text and that of the subject are fused by virtue of the dialogue between the knowing subject and the text:

Coming to an understanding in conversation presupposes that the partners are ready for it and that they try to allow for the validity of what is alien and contrary to themselves. If this happens on a reciprocal basis and each of the partners, while holding to his own ground simultaneously weighs the counter-arguments, they can ultimately achieve a common language and a common judgment in an imperceptible and non-arbitrary transfer of viewpoints.\textsuperscript{98}

The fusion of horizons on the field of the tradition\textsuperscript{99} means that there is only one right interpretation of a particular text for the interpreter at any particular point

\textsuperscript{94} Gadamer, above n 62, 262; an assumption which will not be criticised in this article in any detail. Suffice it to say that such an assumption is at best contentious, and that Warnke's defence of Gadamer on this matter misses the point that the existence of contradictions within a text does not necessarily support the conclusion that there is one dominant meaning which is contradicted - there may well be several possible meanings none of which can be identified as the dominant meaning; see: Warnke, above n 81, 84.

\textsuperscript{95} Gadamer, above n 62, 262.

\textsuperscript{96} Ibid, 102.

\textsuperscript{97} See also: Gadamer, above n 76, 27.

\textsuperscript{98} Gadamer, above n 62, 348.

\textsuperscript{99} Ibid, 273.
in time, as the fusion restores a unity between the text and the tradition in accordance with the reader’s ‘fore-conception of completion’.\textsuperscript{100}

Historical consciousness is aware of its own otherness and hence distinguishes the horizon of tradition from its own. On the other hand, it is itself, as we are trying to show, only something laid over a continuing tradition, and hence it immediately recombines what it has distinguished in order, in the unity of the historical horizon that it thus acquires, to become again one with itself.\textsuperscript{101}

This fusion of alternative viewpoints is apparently predicated upon the ability of the interpreter to transcend and objectify those standpoints in the movement towards the fusion of agreement. This interaction of critical transcendence and prejudices is therefore central to Gadamer’s theory of understanding.

Much of the difficulty, and perhaps also much of the rhetorical force, of Gadamer’s work stems from the fact that some parts of his work could be interpreted on the one hand as advocating a strong form of communal constraint which denies any prospect of critical insight, while on the other hand, other parts of his work are consistent with a critical pluralism. I will therefore briefly review the grounds for these interpretations in order to question Dworkin’s implicit assumption that there is one Gadamerian theory when he suggested that Gadamer is ‘about right’.

2 Gadamer Version 1 - Communal Prejudices and the Determinacy Thesis
At some points in his work Gadamer acknowledged that the process of examining one’s prejudices will be an infinite task,\textsuperscript{102} implying that the transcendental, objective appraisal of competing viewpoints is an impossibility. The consequences of this inevitability of a prejudice-laden understanding

\textsuperscript{100} Ibid, 261. \\
\textsuperscript{101} Ibid, 273. \\
\textsuperscript{102} Ibid, 265-266, 269.
depend upon the nature of the prejudices envisaged by Gadamer. If prejudices are specific to the individual, Gadamer's hermeneutic theory leads to a strong relativism where the number of valid interpretations may equal the number of interpreters, unless there is some means of critically assessing the merits of the various interpretations. On the other hand, if prejudices are monovalent and communal, it would only be possible for interpreters in any particular social setting to reach one right answer.

The interpretation of Gadamer which emphasises the communal character of prejudices is supported by his repeated reference to prejudices as if there could only be one type of prejudice in any community at a particular point in time. Thus, whilst Gadamer rejected the Enlightenment preoccupation with objective truth, his preoccupation with one truth is reflected in scattered references to 'true prejudices' and 'right understanding' constituting the tradition. In a kind of Darwinian selection which he did not explain, Gadamer maintained that the tradition ensures that only those interpretations which fit the tradition will survive. The temporal distance, which is a component of the concept of 'tradition', somehow fulfils a filtering process by which the tradition works itself pure. This process of purification ensures that we are only imbued with 'true' prejudices which comprise 'a unity that is efficacious in our lives':

'It [the filtering process] not only lets those prejudices that are of a particular and limited nature die away, but causes those that bring about genuine understanding to emerge clearly as such. It is only this temporal distance that can solve the really critical question of hermeneutics,

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103 Evident in Gadamer's definition of a person who 'has an horizon' as meaning a person who 'knows the relative significance of everything within this horizon, as near or far, great or small' (ibid, 269).

104 Ibid, 266. Note that Fish also adopts a pragmatic theory in which the reader is apparently free to create her own meaning, but that Fish seeks to restrict the apparent anarchy which would flow from this approach by invoking the concept of common interpretive strategies which constrain the range of possible interpretation which readers might adopt - see the discussion of the work of Stanley Fish below, under the heading 'Accommodating Pluralism'.

105 Gadamer, above n 92, 137.
namely of distinguishing the true prejudices, by which we understand, from the false ones by which we misunderstand.'\textsuperscript{106}

Even in the face of the threat to the monovalence of the tradition posed by multiculturalism, Gadamer maintained that the tradition would offer a reassuring standard by which to assess competing interpretations:\textsuperscript{107}

This is something that hermeneutical reflection teaches us: that social community, with all its tensions and disruptions, ever and ever again leads back to a common area of social understanding through which it exists.\textsuperscript{108}

In the same paper Gadamer emphasised the nationalist aspect of the tradition, implying that there is one national tradition rather than a plurality of traditions:

Actually, the historian even the one who treats history as a "critical science," is so little separated from the ongoing traditions (for example, those of his nation) that he is really himself engaged in contributing to the growth and development of the national state. He is one of the "nation's" historians; he belongs to the nation. And for the epoch of national states, one must say: the more he may have reflected on his hermeneutical conditionedness, the more national he knows himself to be.\textsuperscript{109}

Within this framework of true prejudices inevitably guiding interpretation, it is not surprising that Gadamer adopted a determinacy thesis founded upon a soft relativism, which acknowledges the existence of a communal consensus upon fundamental values The implication of this soft relativism for legal theory is that the validity of the legal order is purportedly accepted as valid by everyone.\textsuperscript{110}

\textsuperscript{106} Gadamer, above n 62, 266.
\textsuperscript{107} 'Since the human intellect is too weak to manage without prejudices it is at least fortunate to have been educated with true prejudices'; ibid, 242; and 'True prejudices must still finally be justified by rational knowledge, even though the task may never be able to be fully completed'; ibid, 242.
\textsuperscript{108} Gadamer, above n 76, 42; see also: Gadamer, above n 62, 262.
\textsuperscript{109} Gadamer, above n 76, 28.
\textsuperscript{110} Gadamer, above n 62, 294.
It is part of the idea of a legal order that the judge's judgment does not proceed from an arbitrary and unpredictable decision, but from the just weighing-up of the whole... This is the reason why, in a state governed through law, there is legal certainty, i.e. it is possible to know, in principle, what the exact situation is.\textsuperscript{111}

Given Gadamer's apparent endorsement of an omnipresent, monovalent, national tradition, it is understandable that some commentators have interpreted his theory as merely endorsing the status quo. It would seem impossible to transcend the national tradition to some critical perspective, or to even assume the perspective of an alternative standpoint.\textsuperscript{112} This emphasis upon the ontology of the monovalent tradition comprising 'true' prejudices therefore seems to simultaneously exclude any prospect of a transcendental critical theory, the relativism of Foucault\textsuperscript{113} and the differance of Derrida.

3 Gadamer Version II - A Critical Hermeneutics?

But in some passages Gadamer seems to have suggested that the interpreter can transcend her or his prejudices 'so that the text, as another's meaning, can be isolated and valued on its own.'\textsuperscript{114} Gadamer therefore suggested that, contrary to Habermas' assertion,\textsuperscript{115} hermeneutics did not necessitate the surrender to tradition:

\begin{itemize}
  \item \textsuperscript{111} Ibid, 294.
  \item \textsuperscript{112} Ibid, 269; For a discussion of this aspect of Gadamer's work see: J Habermas, above n 76, 335; T McCarthy in Hoy and McCarthy, above n 72, 41; Jurgen Habermas, \textit{The Philosophical Discourse of Modernity}, (trans F Lawrence, 1987) 344-7; Eagleton, above n 12, 72-4; but cf Warnke, above n 81, where Warnke argues for a critical hermeneutics which accepts the importance of prejudices without conceding that they are determinative.
  \item \textsuperscript{113} For a defence of Gadamer from the charge of relativism see: Hekman, above n 83, 115.
  \item \textsuperscript{114} Gadamer, above n 62, 266; see also: 'A person who has no horizon is a man who does not see far enough and hence overvalues what is nearest to him. Contrariwise, to have an horizon means not to be limited to what is nearest, but to be able to see beyond it. A person who has an horizon knows the relative significance of everything within this horizon, as near or far, great or small. Similarly, the working out of the hermeneutical situation means the achievement of the right horizon of enquiry for the questions evoked by the encounter with tradition'; ibid, 269. See further, ibid, 495-6.
  \item \textsuperscript{115} For a discussion of the work of Habermas see below under the heading 'Theorising Determinacy in A Multicultural World - Habermas' Discourse Ethics'
\end{itemize}
But is man as a political being the mere object of the techniques of making public opinion? I think not: he is a member of society, and only in playing his role with free judgment and politically real effectiveness can he conserve freedom. It is the function of hermeneutical reflection, in this connection, to preserve us from naïve surrender to the experts of social technology.  

This critical engagement with a text is fundamental to Gadamer's discourse upon effective historical consciousness. Such critical engagement suggests that we do more than 'come home to our communal tradition' when engaging with a text - the interpreter is compelled to critically review her prejudices.

4 Can the Differing Versions of Gadamer's Work be Reconciled?

There are therefore at least two conflicting interpretations of Gadamer's hermeneutic theory. On one view, Gadamer reclines in the comfort of what is perceived to be a conservative, stable status quo, whilst on the other view, he grapples with an account of critical theory in a prejudiced world.

In one attempt to reconcile Gadamer's apparent aspiration to a critical perspective with his acknowledgement of prejudice, Hoy drew upon the discourse theory of Foucault Hoy argued that a pluralist interpretation of Gadamer's work is an appropriate foundation for a critical hermeneutics. This pluralist reading of Gadamer suggests that the tradition is not one coherent unity but multifaceted, that there are multiple traditions, each competing for supremacy in a manner reminiscent of Bakhtin's dialogic theory of meaning which emphasised the social, diachronic construction of meaning. Hoy argues that any member of a community is therefore exposed to any number of

116 Gadamer, above n 76, 40.
117 Hoy and McCarthy, above n 72, 144-200.
118 There are also suggestions of this pluralist interpretation of Gadamer in Warnke’s work; see: Warnke, above n 81, 103.
alternative standpoints, and that hermeneutics requires that the member take these standpoints seriously and, accordingly, examine his or her own prejudices from the alternative standpoints. But the major shortcoming with this approach is that neither Hoy nor Gadamer explains how it is possible for a person invested with prejudices to transcend those prejudices in order to examine their original prejudices. Surely a prerequisite of such a process would be a universal medium of discourse if the two standpoints were not to talk past each other.

5 Dworkin’s Debt to Gadamer
Regardless of whether there is a right interpretation of Gadamer, it is clear that Dworkin was either ignorant of the competing interpretations of Gadamer’s work or chose to ignore the debate. By overlooking the second, pluralist, interpretation of Gadamer’s work, Dworkin was perhaps too hasty in arriving at the closure of legal determinacy. In *Law’s Empire* Dworkin moved from the proposition that Gadamer ‘strikes the right note’ to the view that the interpretation of legal texts is ‘instinctively’\(^\text{120}\) governed by a principle of integrity which dictates that texts are interpreted in accordance with the assumed omnipresent and monovalent moral tradition of the ‘true community’.\(^\text{121}\) The influence of Gadamer in this crucial aspect of Dworkin’s theory is unmistakeable. It is because of his preparedness to construct one community with one coherent set of moral principles governing legal interpretation that Dworkin was prepared to adopt Gadamer’s conclusion that legal officials could

\(^{120}\) Dworkin, above n 1, 183; for a critique of Dworkin’s reporting of social ‘facts’ such as common beliefs, despite a lack of empirical research to support such observations, see: Robert Moles, ‘The Decline and Fall of Dworkin’s Empire’ in A Hunt (ed) *Reading Dworkin Critically* (1992) 71, 83.

produce one right answer. \(^{122}\) This right answers thesis remains the central aspect of Dworkin’s theory, \(^{123}\) and is the basis upon which Dworkin rejects any suggestion of legal pluralism. It is because of his preparedness to assume the existence of a community with a coherent scheme of principle that Dworkin scoffed at suggestions that the law might be considered by some to be unfair, stating that ’no one really thinks the law wicked or its authors tyrants.’ \(^{124}\) According to Dworkin, the ’true society’ is a no go zone for disaffected minorities: conflict exists, but it is conflict concerning which interpretation of monovalent communal principles is consistent with past practices and prevailing social morality as interpreted by state officials - it is conflict within the constraints of Dworkin’s paradigm of law busily ’purifying’ \(^{125}\) itself through the actions of state officials. \(^{126}\)

As with Gadamer, Dworkin’s work may therefore be understood to acquiesce in the impossibility of transcending any given context in achieving a universal standpoint for critique, and therefore as negating any possibility of critical insight, because legal officials are inextricably a part of ’their’ legal project. In this respect, Dworkin’s focus upon one communal morality is remarkably similar to Rorty’s soft relativism. According to Rorty, after Gadamer it is clear that ’we’ cannot be critical of alternative projects which differ from ’our’ own because there is no universal critical standpoint. Dworkin is therefore comfortable in bringing ’internal skeptics’ such as Rorty aboard his depiction of Neurath’s boat. \(^{127}\) According to both Rorty and Dworkin, there can be no critique of ’our’ project, because we are hermeneutically chained to it and

\(^{122}\) Gadamer, above n 62, 294.

\(^{123}\) Dworkin, above n 1, viii-ix.

\(^{124}\) Dworkin, above n 1, 111.

\(^{125}\) Ibid, 407-410.

\(^{126}\) Whilst Dworkin was by no means a Nazi sympathiser, there is a resemblance between Dworkin’s subsumption of minority moralities within ’our’ culture and Gadamer’s comments in his Paris lecture delivered in 1941. See: Warnke, above n 81, 71-72; see also: Gadamer, above n 76, 28.

\(^{127}\) Ibid, 82-83.
therefore cannot transcend our lifeworld in some critical moment. Truth is what is 'right for us' - a chilling prospect for some, and a poor account of discursive practice for others.

This pursuit of coherence is not unique to Gadamer and Dworkin, but shared with reception theorists such as Iser who suggested that texts ought to be read so as to 'normalise' any indeterminacy and thereby achieve a coherence within the text. Eagleton suggests that this willingness to overcome dissonant voices within a text is merely a result of the influence of Gestalt psychology, while the impulse to coherence of psychoanalytic theory may also be discerned. Whether or not Eagleton is correct, the point is that Gadamer's observation that true understanding requires texts to be interpreted as internally coherent, and Dworkin's Neptune of integrity, are not naturally occurring phenomena. Rather, they are constructed ideals of a particular political vision. Norris criticises such ontological theories on the basis that their version of social

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128 Dworkin's suggestion that a judge may transcend the prevailing norms of communal morality is strikingly weak in the context of his adherence to the right answers thesis; see: Dworkin, above n 1, 219.
129 See, for example, the work of Christopher Norris, especially What's Wrong with Postmodernism, (1990); Christopher Norris, Uncritical Theory, postmodernism, intellectuals and the Gulf War, (1992). Indeed, as noted by Georgia Warnke, in a lecture delivered in 1941 Gadamer cited the tradition of the 'volk' as superior to the claims of democracy, see: Georgia Warnke, above n 81, 71-2. For a critique of Dworkin's work from this standpoint see: Sandra Berns, 'Integrity and Justice or When is Injustice Mandated by Integrity?' (1991) 18 Melbourne University Law Review 258.
132 Eagleton, above n 12, 81.
133 Gadamer, above n 62, 261; see also: 259, 261-262, 262; Hoy argues that whilst a universalist interpretation of Gadamer is open, so also is a pluralist interpretation such that deconstruction and Gadamerian hermeneutics are not necessarily incompatible, see: Hoy and McCarthy, above n 72, 188ff. Whilst it is certainly the case that Gadamer recognises that there is no prospect of universal truth (Gadamer, above n 62, 270), by his approach to tradition and his emphasis upon achieving unity he does seem to suggest that at any particular time there is one true interpretation.
134 See: Dworkin, above n 1.
135 For further critical discussion of the assumption of coherence see: Paul de Man, Blindness and Insight: Essays on the Rhetoric of Contemporary Criticism (1971).
relativism paralyses debate by omitting mention of the contests of power ‘out there’, in which often powerful interests seek to manipulate discourse to further their own interests. The lesson of the Gulf War, Norris continues, is a telling example of the attempt by the military and supporters of the war to manipulate the mass media in stifling dissent. Only a critical theory of social discourse, Norris argues, can rationalise the existence and rationality of those who stand against the mass media tide in constructing an alternative discourse on such events as the Gulf War. Norris observes that the theorisation of social discourse on the Gadamerian assumption of ‘our’ tradition or ‘our’ project cloaks the existence of social dissent. Perhaps in an ideal world we would all loll around in club chairs engaging in Rorty’s ‘interesting conversations’ without ever having to make a decision. In the ‘real world’, however, facts are interpreted, laws are interpreted and decisions are made. Often such interpretive decisions are imposed over a more or less vocal dissent. This dissent poses a threat to the communal monovalence underpinning Dworkin’s determinacy thesis. It is therefore necessary to briefly consider the existence of such pluralism before turning to alternative theories of discourse which acknowledge such a plurality of views.

6 Cultural Heterogeneity, Psychoanalysis and the Foundations of Dworkin’s Theory

As Taylor has noted, modern social theory is heavily influenced by this assumption of some fundamental commonality bonding all members of any particular community, such that a common set of founding assumptions is possible. Wittgenstein suggested that meaning is founded upon agreement, apparently ignoring the conundrum that a community would initially have to

136 See, for example, the work of Norris cited at n 129.

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agree upon what such agreement comprises. Similarly, it is the belief in a homogeneous tradition as the foundation of interpretive constraint which underpins both Dworkin’s and, perhaps Gadamer’s, right answers thesis. I will challenge the existence of this communal homogeneity by arguing that there is not a common set of founding assumptions, that there is not one tradition. It will be argued that the assumption of one community is flawed on two counts. Firstly, it ignores the existence of pluralist communities. Secondly, there is the assumption that members of the community are coherent selves, despite the considerable psychoanalytic literature after Freud and Lacan to the contrary.

That we live in a pluralist community is, in these times, a trite observation. The wealth of literature springing from liberal theory’s requirement for tolerance of autonomous selves is testimony to the modern recognition of this pluralism. However, Rockefeller has questioned the assumption of multicultural theory, which posits the community as merely fractured into perhaps a relatively small number of sub-cultures. Rockefeller argues that focusing upon the grouping of individuals into a handful of sub-cultures ignores the possibility that there may be numerous tiers of subcultures. Indeed, Taylor traces the breakdown of omnipresent, premodern moral orders and the development of the new order of modernity in which the fear of meaninglessness is experienced at the individual level. This ideology of the autonomous self seems to contradict the subsumption of the individual within any group or ‘culture’.

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141 Steven Rockefeller, ‘Comment’ in Taylor, above n 138, 87-103.
142 Charles Taylor, Sources of the Self (1989) 18; see also: Peter Berger, The Sacred Canopy: Elements of a Sociological Theory of Religion (1969). This burgeoning recognition of the autonomous self, Calhoun observes, is reflected in the Cartesian maxim ‘I think therefore I am’ and Fichte’s idealist ‘I am I’; C Calhoun, ‘Social Theory and the Politics of Identity’ in Craig
In a similar vein, in one essay which served to undermine much of his theory of an all-encompassing institutionalised lifeworld, Fish recognised the diversity of institutions which play a part in influencing the outlook of the subject. While writing about 'the legal institution', Fish conceded that there was no such homogeneous totality. This is because any institution is fractured along numerous fault lines attributable to the singularity of each member, arising from their membership of any number of institutions. Indeed, in some parts of his work, Fish seems to accept that such institutional heterogeneity means that institutions will be wracked with debate about even the most fundamental of institutional objectives. Fish later appeared to resile from this view by suggesting that his theory of legal practice offers as much stability and determinacy as anyone would need. It is difficult to reconcile this conservative shift with his earlier description of institutional practice as an 'engine of change', which evokes the image of fractured and dynamic social institutions which are far from being monolithic structures constraining the discourse of their members.

This growing recognition of the diversity amongst individuals has coincided with the prominence accorded the liberal notion of the essential self, which may be traced back at least as far as Mill. Just as Fish's suggestion of uniquely socialised individuals threatens to undermine the social homogeneity which underpins the determinacy thesis, so the increasing awareness of the


145 Of course, it was the individuation of the subject and the power struggles which ensued which comprised one focus of Foucault's work. For a discussion of this aspect of his work see: Michel Foucault, 'Afterword: The Subject and Power' in H Dreyfus and P Rabinow, Michel Foucault: Beyond Structuralism and Hermeneutics (1982) 208; Michel Foucault, 'About the beginnings of the hermeneutics of the self' (1993) 21 Political Theory 198.


146 Ibid.

147 Fish, above n 72, 156; Fish, above n 72, 189.
autonomous self seeking 'self fulfilment' poses a considerable threat to the posited cultural homogeneity underpinning many theories of legal determinacy. In light of this ongoing preoccupation with the individual, in some respects it is understandable that much modern theory takes as given the concept of the coherent, autonomous self. Thus, Calhoun observes, role theorists generally overlooked the multiplicity of roles which any individual was required to fulfil in ordinary life, social constructionists such as Fish generally depicted individuals as automatons subjected to normativization while other theorists emphasised, and continue to accept, the idea of an essential self.

In more recent times considerable attention has been paid to the view that individuals are confronted with the ‘predicament of rivalry and contestation’ arising from the insertion of the modern subject ‘into a series of separate value-spheres each one of which tends to exclude or attempts to assert its priority over the rest’. In this regard the substantial body of writing dealing with psychoanalytic theory, which portrays the deep divisions within the subject, is particularly pertinent. According to such theories of the self, the individual is constantly engaged in an internal dialogue which never reaches the point of complete self knowledge. Thus in feminist theory Donna Haraway has

148 In relation to this point, Calhoun cites Merton who considered those that did not fulfil the prescribed functions of their roles fell within the ‘deviant’ category - Robert Merton, Social Theory and Social Structure (1968) 185ff. Although, Calhoun notes, Erving Goffman argued that conflict between roles could produce fragmentation of the self; E Goffman, The Presentation of Self in Everyday Life (1959) ch 5.


150 Taylor, above n 142, 318.


argued that there is no essential characteristics of the female self, maintaining that each assertion of a shared characteristic which defines the concept ‘woman’ is merely ‘an excuse for the matrix of women’s dominations of each other.’

The existence of this politics of identity suggests that individuals inhabit unique lifeworlds which themselves are never static but, as Bakhtin recognised, are characterised by the diversity envisaged within his concept of heteroglossia.

**D Theorising Determinacy In A Pluralist World - Habermas’ Discourse**

*Ethics*

The fracturing of communities, and of the self, discussed in the preceding section poses a fundamental threat to the liberal theory of determinacy. If meaning is dependent upon conventional agreement (Hart and Wittgenstein), upon agreement founded upon some communal morality presumably generated by a homogeneous community (Dworkin and Sunstein), or finally if meaning is dependent upon the existence of autonomous, homogeneous institutions (Fish), how can these theories of determinacy survive the recognition that multiculturalism and the fractured self rent asunder any postulated communal homogeneity? The only potentially plausible defence of the determinacy thesis in the face of this pluralism is framed in terms of a universalising rational discourse which transcends the plurality of our world. ‘Rational’ discourse, it might be suggested, can lead us to the one right answer despite the multiplicity of viewpoints which constitute our world.

Of course, it is not only liberals who seek such a critical standpoint from which to assess the merits of truth claims in an interpretive, epistemological or moral.

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155 Bakhtin, above n 119.
context. As many ‘members’ of the critical legal studies ‘movement’ recognise, the hermeneutic monism underlying Dworkin’s legal theory may be rejected on the basis that there is no one tradition which generates the right answers, but this is only the first step in supplanting liberal legal theory with an alternative theory. To create an alternative legal theory consistent with an agenda of reform, either a critical pluralism or a critical standpoint must be invoked as warranting the truth of some alternative legal agenda such as a pragmatic program of reform.\footnote{158} In the absence of such an alternative framework, all that the ‘critical’ scholar could aspire to is the exposure of the perceived contradictions of liberal theory and an admittedly biased attempt to explain how a system so riddled with contradictions could survive. Thus, in attempting to explain the survival of the legal system, critical scholars have often argued that other social theories are mere ideology when viewed from what is portrayed as a superior standpoint. Such critical scholarship is therefore founded upon an external, objectifying perspective (often derived from Marxist theory), upon the basis that the chosen perspective is the one concrete foundation in an otherwise contingent world.\footnote{159} Many liberal and critical scholars therefore share a preoccupation with theorising rational, monist discourse (albeit with different ends in view) in response to the perceived plurality of the lifeworld. It is therefore to an assessment of the merits of such critical theory that we must turn in order to establish whether such critical insight might ground a theory of legal determinacy.

\footnote{159} See, for example, the early Lukacs, who argued that Marxian theory was unique in that it recognised the universality of the class consciousness of the proletariat: see: Gyorgy Lukacs, \textit{History and Class Consciousness}, trans R Livingstone, (1971). In the context of legal theory, Horwitz’s historical study of American law is a classic example of this approach; see: Morton Horwitz, \textit{The Transformation of American Law} 1780-1860 (1977). For a discussion of the problematic nature of the role for ideology within legal theory see: Alan Hunt, \textit{Explorations in Law and Society} (1993).
1 How Might a Determinacy Thesis Accommodate Difference?

A liberal legalist seeking to buttress the determinacy theory against the pluralist threat might be expected to turn to some standpoint theory as the means of transcending and overcoming the value dissent of our fractured world. Such a standpoint may be a universal one, for example that contemplated by Kant and those falling within the critical tradition. Perhaps the most significant contemporary social theorist falling under this broadly universalist rubric is Habermas. Habermas accepted the pluralism of modern society, but sought to modify Kantian and Hegelian critical theory by removing the metaphysical emphasis upon consciousness embodied in the categorical imperative. Instead, he developed a critical theory founded upon his interpretation of the conditions for communication in modern lifeworlds, and therefore provides the key to identifying the social process which underpins the perceived human capacity for critical insight.

2 An Overview of Habermas' Discourse Theory

Reaching understanding is, according to Habermas, 'the inherent telos of human speech.' Understanding is achieved when the recipient can say 'yes' to a

160 Kant, above n 79, para 40.
161 The alternative foundation for a critical standpoint may be class, gender, age, etc. As Calhoun notes, the shortcoming of such essentialist positions is that they fail to account for the marked differences within any of the nominated classes; see: Calhoun, 'The Standpoint of Critique? Feminist Theory, Social Structure, and Learning from Experience' in Calhoun, Critical Social Theory, above n 142, 163.
162 Although Habermas is by no means a liberal social theorist.
164 Habermas, The Philosophical Discourse of Modernity, above n 112, 294-327.
166 Hegel argued that Kant's theory of reason was deficient in that it ignored the role of material conditions in influencing the processes by which we learn of the posited objective world. In turn, Habermas argued that the Hegelian metaphysical preoccupation with the teleological theory of history needed to be overcome if the path to empirical social study was to be cleared; see: Habermas, above n 62, vol 2, 382-3.
167 Habermas, above n 62, vol 1, 8-22, 287; see also: Habermas, above n 50, 1.
validity claim.\textsuperscript{168} Although he recognises that there are different forms of rationality\textsuperscript{169} and intersubjective discourse,\textsuperscript{170} Habermas maintains that rational discourse upon moral and legal norms entails a preparedness to propose validity claims supported by reasons which are open to criticism, with a view to reaching the uncoerced consensus of the populace (and all future people) acting rationally.\textsuperscript{171} At the core of Habermas' theory is the assertion that there is only ever one right answer in the given context, because there is only one answer supported by reasons to which all would assent at any particular spatio-temporal point. Whilst accepting that those reasons may not survive indefinitely, it is the assertion of warranted truth supported by idealised procedural assumptions\textsuperscript{172} which Habermas perceives to be the key to context transcendence.\textsuperscript{173} Without this objective of universal truth, Habermas considered that discursive practice

\textsuperscript{168} Habermas, above n 50, 2; Habermas, above n 62, vol 1, 287-8, 392. This is somewhat problematical, as Couzens Hoy notes that it is possible to understand without agreeing; see: Hoy and McCarthy, above n 72, 182; Jurgen Habermas, above n 13, 246.

\textsuperscript{169} Instrumental rationality, for example, does not depend upon the existence of two knowing subjects, while social interaction obviously does.

\textsuperscript{170} In this regard Habermas is prepared to adopt the classification of speech acts developed by JL Austin; see: Habermas, above n 62, 295ff.

\textsuperscript{171} Habermas, above n 121, 227; Jurgen Habermas, 'Geschichte und Evolution,' Zur Rekonstruktion des Historischen Materialismus, 217, quoted in Hoy and McCarthy, above n 72, 161; Habermas, above n 62, vol 1, 1-22; Habermas, above n 165, 113; Jurgen Habermas, \textit{Legitimation Crisis} (1976) 89. Habermas restricted members of the ideal community to 'all subjects capable of speech and action'; Jurgen Habermas, 'Justice and Solidarity: On the Discussion Concerning Stage 6' in T Wren (ed), \textit{The Moral Domain} (1990) 245. In another elaboration upon the concept of the ideal speech situation Habermas suggested that in such a situation: 'the bracketed validity claims of assertions, recommendations, or warnings are the exclusive object of discussion; ... participants, themes, and contributions are not restricted except with reference to the goal of testing the validity claims in question; ... no force except that of the better argument is exercised; and ... as a result, all motives except that of the cooperative search for truth are excluded.' \textit{Legitimation Crisis}, 107-108.

\textsuperscript{172} Although Habermas has resiled from the 'ideal speech situation' nomenclature in his more recent work, his commitment to the substance of this procedural ideal remains; see generally, Habermas, above n 121. These procedural assumptions include: that participants ascribe identical meanings to expressions, connect utterances with context transcending validity claims and assume that addressees are accountable in the sense that they are autonomous and sincere with both themselves and others; \textit{Between Facts and Norms}, 4. For a discussion of this aspect of Habermas' theory, with references to relevant untranslated material, see: Maeve Cooke, \textit{Language and Reason: A Study of Habermas's Pragmatics} (1994) 31. For consideration of the developments within Habermas' discursive theory see: Stephen Knight, \textit{The Recent Work of Jurgen Habermas} (1988).

\textsuperscript{173} See: Habermas, above n 62, vol 1, 22-42.
would be meaningless, because there would be no criterion for assessing the respective theories posited - a strong relativism would prevail in a frustrating world where we all spoke past each other.

Thus, while Kant considered rationality to be predicated upon what the self-conscious subject can will to be a universal law without self contradiction, Habermas adopted an intersubjective definition of rationality which focused upon what the subject can submit as a universal law to all others for discursive validation in the ideal speech situation. Habermas therefore presents his theory of rationality as a procedural ethics governing discursive practice, a definition which aspires to universality because it purports to contain no substantive norms for the good life.

3 Communicative Action and Legal Adjudication

But how is this theory of communicative action relevant to the determination of legal disputes? Habermas recognised that not all discourse is analogous to the natural sciences, which he assumed to be predicated upon the identification of one truth about the objective world. He identified the discourses of aesthetics, cultural values and literary criticism as examples where there is no one right answer, but nevertheless the statement of reasons plays a considerable role in the furtherance of meaningful discourse. By contrast, it would seem that the determination of moral and legal norms is susceptible to the rationality constituted by a universal consensus upon normative propositions. Habermas therefore considered that the articulation of legal norms is undertaken with the

174 'Discourse or argumentation is a more exacting type of communication ...[It] generalizes, abstracts, and stretches the presuppositions of context-bound communicative actions by extending their range to include competent subjects beyond the provincial limits of their own particular form of life.' Habermas, above n 62, 202.
175 For a critique of Habermas on this point see: Charles Taylor, 'Language and Society' in A Honneth and H Joas, above n 13, 23-35.
176 See: Habermas, above n 62, vol 1, 20.
177 Ibid, vol 1, 19.
belief that a rational consensus upon the law can be reached in ideal circumstances.\textsuperscript{178}

4 The Transparency of Background Assumptions to Rational Discourse

Upon closer examination of his foundational assumptions, it can be argued that Habermas' telos of agreement ignores several arguments which suggest that communicative rationality can be anything but the primary form of discursive practice. Firstly, it will be argued that the idealising assumptions protecting the integrity of rational understanding are so artificial as to threaten the descriptive validity of Habermas' theory. Secondly, even if we accept Habermas' idealising assumptions, it will be argued that it would be irrational for participants in discourse to ever claim to have transcended their own lifeworld in arriving at the universalising perspective envisaged by Habermas. It is therefore argued that Habermas' account is unconvincing as a normative theory.

Before exploring these criticisms in more detail, it should be noted that both stem from the fact that Habermas was prepared to concede some ground to hermeneutic theory by accepting that the days of the Kantian universal perspective have passed. In seeking some foundation for critical insight, Habermas therefore had to draw a compromise which sought to superimpose a rational discourse upon a subjectivised lifeworld background. In contrast to the seemingly central role of the monologic tradition in Gadamer's hermeneutics and Rousseau's republicanism,\textsuperscript{179} the importance of ontological presuppositions within Habermas' theory is that they merely restrict the number of credible

\textsuperscript{178} Habermas, above n 121, 107. Note that Habermas certainly did not consider that such consensus was realistically possible as he explicitly acknowledged the need for coercion to protect rational discourse from those who would compel agreement by overt force; Habermas, above n 171, 87.

reasons proffered in support of a validity claim (without determining the outcome), and therefore enhance the prospect of consensus. Thus Habermas accepted that the subject's understanding is riddled with unthematised knowledge which both holds out the prospect of discursive consensus and also is beyond critical, discursive examination. Habermas believed that this 'invisible' knowledge comprises ideas which are taken for granted, the norms which secure social cohesion, and the competencies and skills that individuals have internalised. Habermas therefore accepted that it would be impossible for participants in discourse to achieve complete transparency of the assumptions flowing from their lifeworld background:

The fundamental background knowledge that must tacitly supplement our knowledge of the acceptability conditions of linguistically standardized expressions if hearers are to be able to understand their literal meaning, has remarkable features: It is an implicit knowledge that cannot be represented in a finite number of propositions; it is a holistically structured knowledge, the basic elements of which intrinsically define one another; and it is a knowledge that does not stand at our disposition, inasmuch as we cannot make it conscious and place it in doubt as we please.

Given that discourse is carried on within this sea of 'invisible' knowledge, any validity claim will necessarily carry many implicit assumptions. Participants

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182 Habermas, Theory of Communicative Action, above n 62, vol 1, 336-7; But cf Maeve Cooke, above n 172, 15-16, where she argues that the pre-reflective background would not escape the critical gaze of modern society.

183 Habermas, above n 62, vol 2, 119-52; see also: Theory of Communicative Action, vol 1, 70. Paradoxically, whilst Habermas criticised Foucault for self contradiction in positivistically unveiling power whilst simultaneously rejecting the knowing subject, he maintained that the unthematised knowledge of the background invisible to discursive participants is nevertheless susceptible to his analysis; see: Habermas, The Philosophical Discourse of Modernity, above n 112, 266-293.
would therefore never be in a position to know themselves in the sense of the knowing subject postulated by the Enlightenment. The problem with the aspiration to context transcendence embodied in Habermas' theory of communicative rationality is that it does not seem to sit at all well with his acceptance of the apparently considerable influence of the lifeworld background upon discourse.

(a) Mutually Understood Terms

Turning to the assumption of mutually understood terms, the consequences of this assumption for Habermas' theory are twofold. Firstly, it explains the shared background of understanding to which Eagleton and Altman referred, and thereby explains why in ordinary discourse we seem to be able to minimise the number of issues which need to be addressed with a view to achieving a consensus. Secondly, it makes the telos of agreement appear to be a logical keystone of rational discourse. Without knowing or assuming that they have proceeded from a common standpoint, participants could not rationally believe that consensus might ultimately be achieved.185 As with Gadamer, for Habermas the existence of the lifeworld background therefore constitutes a positive phenomenon which facilitates discourse.

Unlike the interpretation of Gadamer's work which suggested that he envisaged a monologic tradition, Habermas acknowledged the existence of a plurality within modern Occidental community(ies) and therefore faced the problem of explaining how it was possible for discursive participants from different backgrounds to interact with the purpose of achieving understanding. Habermas maintained that discursive participants must assume away the consequences of this potentially disruptive plurality by accepting that the terms of their discourse

184 Habermas, *Theory of Communicative Action*, above n 62, vol 1, 336. See also: vol 1, 70; Habermas, 'A Reply' above n 13, 244-5.
are mutually understood. However, the preceding discussion of multiculturalism and the fractured self suggests that it would be rational to expect that in a pluralist world there would be a real prospect (if not an inevitability) of discursive participants beginning from disparate backgrounds, and that this difference would also be reflected in disparate understandings of discursive terms. Further, in the absence of transparent background assumptions, it would be impossible for discursive participants to know that they all begin from a common set of assumptions.

It is therefore difficult to understand how Habermas can claim that it would be rational for participants to assume that they all commence from a common understanding of discursive terms. If participants do not even know that they are beginning from a common foundation and are rationally precluded from assuming it, how can they be sure that they have reached the sort of consensus envisaged in Habermas' ideal speech situation?

(b) The Scope and Significance of Background Knowledge

Even if Habermas' foundational assumption as to a shared understanding of discursive terms is accepted, the postulate of context transcending validity claims is also problematic. The question here is the scope of what Habermas at times calls the 'pre-reflective' background knowledge: the broader the scope of such knowledge the closer Habermas moves to accepting that discursive participants must uncritically accept the constraint of a monologic tradition in a

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185 Habermas, above n 62, vol 1, 13. See also: Habermas, *The Philosophical Discourse of Modernity*, above n 112, 326.
186 See above n 172. See also: Habermas, above n 13, 219.
187 See the discussion in Part IV ‘Determinacy, Cultural Heterogeneity and Psychoanalysis’
190 Although there are instances where Habermas appears to suggest that all knowledge will be subject to critical review; see: Habermas, ‘A Reply’ in Honneth and Joas, above n 13, 223-4.
way strikingly similar to that envisaged in the ‘monologic’ interpretation of Gadamer’s work.

The term ‘background’ implies that such pre-reflective knowledge is relatively limited, but on the other hand Habermas apparently accepted that an understanding of gravity falls within the pre-reflective background knowledge.191 It is therefore difficult to know the limits of this pre-reflective knowledge and, furthermore, the basis upon which Habermas implied that such knowledge comprises a relatively small portion of total knowledge. Regardless of the scope of this unthematised background knowledge, it is difficult to understand how a participant can claim to be acting rationally when they tender what they present as universal reasons for validity, knowing all the while that there can be no such universality owing to the prejudices of the background which influence the presentation and content of those reasons. Indeed, Habermas concedes that the assumption of context transcending validity claims is rather thin when he acknowledges that an agreement will always be subject to revision in the light of better arguments and that discursive participants will embrace the ephemeral nature of validity claims.192

5 Habermas’s ‘Transcendental Theory Hope’

The fact that the assumptions underpinning the ideal speech situation are not achievable is not the point, according to some statements of Habermas193 and some of his supporters such as McCarthy.194 What is important is our acceptance of the fact that the ideal at least to some extent constrains our

191 Habermas, above n 62, vol 1, 336.
192 Habermas, above n 121, 226-7; for a discussion of this perceived shortcoming in Habermas’s work see: Hoy, in Hoy and McCarthy, above n 72.
193 Habermas, above n 180, 206; The Philosophical Discourse of Modernity, above n 112, 322; Habermas, above n 165, 235.
194 McCarthy in Hoy and McCarthy, above n 72, 217ff. See also: Cooke, above n 172, 112ff.
practice.\textsuperscript{195} Thus, the argument continues, even if participants accept the impossibility of complete understanding of the background, they would nevertheless appraise what appeared to be the aspects of the background relevant to the particular validity claim.

This admission of the impossibility of the truly transcendental assessment of validity claims, while retaining the aspiration to such a universal standpoint, merely strengthens the objections of pragmatists such as Rorty and Fish. Thus Fish disparagingly refers to much critical legal scholarship as merely perpetuating the ‘transcendental theory hope’ of the Enlightenment.\textsuperscript{196} Those, such as Hoy, who wish to retain some room for critical insight whilst accepting the artificiality of universalist aspirations, query whether the appeal to an ideal made by Habermas and McCarthy is pragmatically necessary in engendering ‘genuine’ discourse. Indeed, Hoy suggests, an appeal to ‘truth’ as determined by an unattainable ideal is merely one more rhetorical tool which may do more harm to ‘genuine’ debate than any good arising from an appeal to an unattainable ‘truth’.\textsuperscript{197} In contradistinction to a critical monism dependent upon an appeal to an empty procedural ideal, Hoy and others propose a critical

\textsuperscript{195} Given the insistence by Habermas upon consensus and truth in such texts as Habermas, ‘What is Universal Pragmatics?’, in above n 50 and Habermas, above n 62, vol 1, 8-22, 26, it is difficult to account for McCarthy’s views as a valid interpretation of Habermas rather than a revision of Habermasian theory. Habermas does accept that if the ideal speech situation is not achieved other forms of communication such as strategic communication (where the intention is to achieve a particular consequence rather than to reach understanding) prevail; see: ‘What is Universal Pragmatics?’, in above n 50, 3-4. But if the ideal speech situation is never achieved in actual practice, Habermas’ theory of communicative action has nothing to say about actual discursive practice. See also: Norris, Uncritical Theory, above n 129, 62.

\textsuperscript{196} Fish, above n 72, 180-199.

\textsuperscript{197} Hoy in Hoy and McCarthy, above n 72, 249ff; for further criticism of the utopian elements of Habermas’s discourse theory see: Y Sintomer, ‘Power and Civil Society: Foucault vs. Habermas’ (1992) 18 Philosophy and Social Criticism 357.
pluralism which seeks to accord mutual respect to discursive participants on the basis that they are rational autonomous agents.\footnote{198}

**E Critical Theory And Pluralist Hermeneutics**

The perceived failure of Habermas to offer a convincing theory of critical monism in a pluralist world\footnote{199} has led those seeking a critical theory to adopt alternative reconciliations of hermeneutics with critical theory, and in particular to explore the possibility of a critical theory born of the contests envisaged by a pluralist hermeneutics. If multiple lifeworlds at any point in time are a reality, Hoy suggests,\footnote{200} might it not be enough for the critical appraisal of interpretations to invite consideration of a theory from the perspective of other lifeworlds which actually exist? Given that Habermas accepted that discourse can never be founded upon a transparent understanding of the background, he tacitly acknowledged that this appeal to other lifeworlds was what actually happened in everyday discursive practice. Perhaps an equally plausible interpretation of discursive practice would accept that what we put forward, for example in the human sciences, is an interpretive theory which best describes our perception of the facts as we understand them today. Our purpose for putting forward the theory is arguably to test it in the community to which it is disclosed in order that lacunae, inaccuracies, unsupported assumptions and so forth may be revealed and the theory either modified or discarded.\footnote{201}

In other words, the practical application of a pluralist theorisation of critical discourse, such as that propounded by Hoy, differs little from the application of

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\footnote{198} See, for example: Couzens Hoy in Couzens Hoy and McCarthy, above n 72, 249ff; Maeve Cooke, ‘Habermas, Autonomy and the Identity of the Self’ (1992) 18 Philosophy and Social Criticism 18.

\footnote{199} For criticism of Habermas’ commitment to an unconstrained consensus in the context of a pluralist lifeworld see: Selya Benhabib, Critique, Norm and Utopia (1986); McCarthy, Ideals and Illusions: On Reconstruction and Deconstruction in Contemporary Critical Theory (1991); Cooke, above n 172, 153.

\footnote{200} Hoy in: Hoy and McCarthy, above n 72, 260-2.

\footnote{201} Ibid, 262; Warnke, above n 81, 132.
the critical monism of Habermas. Both envisage a rational debate in which competing interpretations are subjected to the furnace of peer review. The key difference is in the concept of the purpose of such discourse. Habermas maintains that all discourse is premised on the search for truth, or the best interpretation, through a consensus reached by all rational, fully informed subjects participating in an ideal speech situation. On the other hand, a hermeneutic pluralist such as Hoy accepts that truth may be an outcome of discourse while refusing to make that the ultimate objective.

1 The Problem with Critical Pluralism

Hoy's theory, it has already been noted, rejected the discourse of 'truth', but argued that one interpretation would be jettisoned in favour of another because it was 'better'. But Hoy does not elaborate upon the standard applied in determining whether an interpretation is 'better'. Calhoun has similarly attempted some form of compromise between hermeneutic and critical theories by jettisoning 'truth'. After recognising the politics of identity he can only suggest that the best we can do is to come up with differing accounts, one of which may for the time being be of greater use for a particular pragmatic purpose. What we seek, Calhoun observes, 'and indeed often achieve - is not

202 For an early discussion of this in the context of legal interpretation see: Couzens Hoy, above n 70, 355.
203 For a similar approach to that of Couzens Hoy see: Warnke, n 72, 132; Warnke, above n 81; Desmond Manderson, 'Beyond the Provincial: Space, Aesthetics, and Modernist Legal Theory' (1996) 20 Melbourne University Law Review 1048. See also: Cooke, above n 172, 157ff where Cooke argues in similar vein for a procedural standard for the assessment of discourse rather than focusing upon consensus as the ideal. For application of this approach in developing theories of deliberative democracy see, for example, James Fishkin, Democracy and Deliberation: New Direction for Democratic Reform (1994) 4; Cass Sunstein, 'Interest Groups in American Public Law' (1985) 38 Stanford Law Review 29-87.
204 Calhoun Critical Social Theory, above n 142, 7 n 14; 51, 66.
consensus as such, but adequate mutual understanding for the pursuit of various practical tasks in which we are jointly engaged.  

This merely begs the questions of what understanding can be 'adequate', and in relation to whose pragmatic purpose? By suggesting that there is, at any point in time, one project (whether local or general) in which the entire community has consensually chosen to participate, Calhoun contradicts his earlier acknowledgement of the politics of identity. Furthermore, Calhoun fails to explain how such a consensus upon one project is possible in the first place. If there can be consensus upon one project, however localised, why can't there be consensus upon everything and hence, no politics of identity? Moreover, in the context of legal theory, Calhoun inexplicably suggests that the attribution of legal meaning is a special case in which meaning will be founded upon consensus. In contrast to Calhoun, it might be argued that the implications of the politics of identity must be accommodated with a theory of legal interpretation. This can only occur if it is accepted that the existence of some communal project is at best highly contextualised and contingent, only made, not always already there.

The ranks of commentators embracing this pluralism born of the politics of identity continue to grow, all accepting that it is a 'good thing' to foster such a multiplicity of views. This multiplicity of views, they suggest, is for the good because only from such social pluralism can 'better' theories surface. However, none of these commentators is prepared to define what they mean by 'better'. Given that critical pluralists reject any universalising standpoint from which to assess the respective merits of competing theories, it is difficult to

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205 Calhoun, 'Social Theory and the Politics of Identity' in Calhoun, Social Theory and the Politics of Identity, above n 142, 51.
206 For example, during the Gulf War was there really only one communal purpose? For a critique of postmodernist theory and its uncritical implications for localised social action see: Christopher Norris; Uncritical Theory, above n 129.
207 Calhoun, 'Social Theory and the Politics of Identity', above n 142, 51, 52.
understand how the meaning of a ‘better’ theory can itself be anything other than controversial and beyond universal acceptance. If one accepts the politics of identity and the pluralism which it spawns, it is difficult to see how such ‘critical’ pluralism can be truly critical and resist the slide into, at least, the soft relativism of Rorty, where ‘hey man, what’s good for us is good’ is the catchcry.

**F A Pragmatic, Pluralist Theory of Interpretation**

1 *Accommodating Pluralism*

From the preceding discussion it may be seen that in more recent times theories of determinacy have been founded upon both hermeneutic and universalist propositions. Gadamer, Habermas, Fish, Rorty and Calhoun all sought to exclude power by recourse to some shared tradition, ideal or pragmatic project which engendered a social consensus. Hoy and Lyotard preferred to deal with discourse in an abstract way, remaining silent on how a pluralist discursive theory would apply in practice when decisions have to be made. The principal critique of such theories offered by this chapter has been that, by admitting the pragmatism of language and by failing to offer a convincing account of language use in the context of the politics of identity, these theories have failed.

If there is a multiplicity of sub-communities and hence potentially infinite applications of a signifier, does this mean that there is no truth, no meaning, no ‘best interpretation’? Altman is one commentator who has interpreted (in a self-serving way) the indeterminacy thesis to suggest this. Altman, above n 1, 92-3. Curiously, Altman discounts ‘deconstruction’ without one reference to Derrida, just one reference to Foucault and only a few pages dealing with several legal theorists. The passage from Foucault quoted by Altman, when placed in the context of Foucault’s work, does not necessarily support Altman’s interpretation that indeterminacy equates with an absence of meaning. Foucault and other ‘radical relativists’, Altman’s terminology not mine, argue that there is no essential meaning, that meaning is created in any given context. Indeterminacy, then, does not necessarily mean an absence of meaning. Rather, indeterminacy merely suggests that there is a choice between possible meanings.

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208 See material cited at n 203.
209 Altman, above n 1, 92-3. Curiously, Altman discounts ‘deconstruction’ without one reference to Derrida, just one reference to Foucault and only a few pages dealing with several legal theorists. The passage from Foucault quoted by Altman, when placed in the context of Foucault’s work, does not necessarily support Altman’s interpretation that indeterminacy equates with an absence of meaning. Foucault and other ‘radical relativists’, Altman’s terminology not mine, argue that there is no essential meaning, that meaning is created in any given context. Indeterminacy, then, does not necessarily mean an absence of meaning. Rather, indeterminacy merely suggests that there is a choice between possible meanings.
identity mean, as some 'deconstructionists' have suggested,\(^{210}\) that meaning is what we, individually, choose to make of any speech act in some anarchic frenzy. There is, as HLA Hart once said in a quite different context, the need for a 'fresh start' in offering a theory of language which rejects both the determinacy thesis and also the nihilism and apathy that some deconstructionists apparently endorse.

In light of the earlier discussion of pluralism, the beginning of such a fresh start must be the acceptance of the pluralism born of the politics of identity. As has been argued above, such pluralism is clearly incompatible with the universalist aspects of Habermas’ work, the monologic discourse of the monist interpretation of Gadamer’s work and also Rorty’s ethnocentric community. In a pluralist world a multitude of interpretive communities is inescapable. In this regard Fish’s recognition that interpretation occurs at a host of localised sites is an important starting point for a pluralist theory of legal interpretation.\(^{211}\) However, there must be reservations concerning Fish’s depiction of a lifeworld mysteriously divided into autonomous, homogeneous institutions.\(^{212}\) Further, as even Fish has acknowledged at times, the notion of institutional autonomy and homogeneity does not stand up to close scrutiny. Indeed, Fish acknowledged that individuals may come to challenge the assumptions which they have ‘inherited’ and thereby discard those assumptions in favour of another set of assumptions.\(^{213}\) Further, Fish conceded that members within an institution may

\(^{210}\) See, for example, J Hillis Miller, *The Ethics of Reading* (1987).

\(^{211}\) Fish, above n 58, 97-8.

\(^{212}\) It is beyond the scope of this chapter to explore the shortcomings of Fish’s theory in any detail. Suffice it to say that Fish at no stage offers an account of how such institutions came into existence other than offering vague suggestions of some social contract like allocation of institutional function; see, for example: Fish, *Is There a Text in This Class?* above n 58, 97-8. One critical problem which Fish does not address is how it was possible for there to be communal discourse and agreement upon such an allocation of institutional tasks if meaning is institution specific and *postdates* such an agreement.

\(^{213}\) 'This does not mean that one is always a prisoner of his present perspective. It is always possible to entertain beliefs and opinions other than one's own; but that is precisely how they will be seen, as beliefs and opinions other than one's own, and therefore as beliefs and opinions

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have quite different understandings of the particular institutional enterprise. The Vietnam War, he notes, had different effects upon participants within the 'literary studies' institution, depending upon 'whether or not their conception of what they [did], their sense of the enterprise, [was] bound up in an essential way with political issues.'\textsuperscript{214} In a similar vein he argued that the change wrought by Chomskian linguistics was only relevant to those in the literary community who already considered themselves linguists.\textsuperscript{215} In the context of law, Fish observes:

Rather than being an embarassment, the presence in contract doctrine of contradictory versions of the enterprise is an opportunity. It is in the spaces opened by the juxtaposition of apparently irreconcilable impulses - to be purely formal and intuitively moral - that the law is able to exercise its resourcefulness.\textsuperscript{216}

In the absence of the stabilising effect upon meaning flowing from the existence of these homogeneous, autonomous interpretive communities, we must accept that legal arguments may be subjected to critical review not only by members of the legal institution, but by a wide spectrum of the community.\textsuperscript{217} Once the construct of one interpretive community is rejected, the theorisation of social discourse must turn away from consensus by the broad community or by some sub-community as the foundation of discourse.

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\textsuperscript{214} Fish, \textit{Doing What Comes Naturally: Change, Rhetoric, and the Practice of Theory in Literary and Legal Studies}, above n 144, 151.

\textsuperscript{215} Ibid, 147-8. It is because of cases such as this, where linguistics as a distinct discipline preceded Chomskian linguistics, that Fish argues that change can only occur where it is anticipated within the relevant interpretive community.

\textsuperscript{216} Fish, above n 71, 161.

\textsuperscript{217} Many decisions of the judicial branch of government are reported in the media, ranging from summaries of penalties imposed upon the latest group of drink drivers to controversial judicial observations to detailed analyses of particular judgments. Aside from scrutiny by the mass media, many decisions will be examined by a host of 'non-legal' people including the litigants in the instant case, people seeking their own legal advice, and members of various interest groups and political lobbyists. The process by which just some decisions are considered worthy of widespread review itself calls for further study. However, for present purposes, the point is that the critical audience might be a small portion of any particular community or it might be all of the community.
The absence of personal and cultural homogeneity postulated by the politics of identity suggests that there can be no 'right' interpretation as such, whether under hermeneutic or universalist models. At the individual level, the interpreter's interpretation of a text reflects the outcome of a balancing of the differing and often contradictory aspects of the self in arriving at an arbitrary conclusion as to what the text means. For any interpreter, an interpretation is therefore a contingent point on a continuum of personal change, as the competing aspects of the self are reconsidered and new compromises reached. At the social level, in a heterogeneous community there will also be a number of interpretations vying for supremacy. The identification of the 'best' interpretation ultimately constitutes an act of power founded upon a subjective decision regarding the acceptability of the warrants of authority accompanying the competing interpretations to disparate parts of the community. To put this another way, in a world where there is no one 'natural', 'rational' or hermeneutically ascertained meaning, and where power infiltrates every nook of social being, the attribution of meaning is inescapably an act of power.

2 The Role of Power

There are broadly three reactions to such an assertion of the inevitability and ubiquity of power in all social relations, including adjudication. The prospect of such a role for power within any theory of interpretation is anathema to liberal legalists, who portray the exercise of such power in a negative light. Under liberal theory power is legitimated either expressly or impliedly by the consent

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218 Dyson argues that we need to move away from essentialising assumptions regarding characteristics of members of any grouping such as those of class or race: M Dyson, Reflecting Black: African American Cultural Criticism (1993). See also: Diana Fuss, Essentially Speaking: Feminism, Nature and Difference (1989) xii.

219 Of course, there is no clear dichotomy between the individual and the social level, the differentiation only being used here as an aid to explication.

220 The concept of warranted assertions being taken from Rorty, see: Rorty, Consequences of Pragmatism, above n 31, 136.
of autonomous rational subjects.\textsuperscript{221} If adjudication involved the illegitimate (non-consensual) exercise of power, they say, we must inevitably slide back into the anarchic morass of the Dark Ages from which we were saved by legal determinacy.\textsuperscript{222} No, liberal legalists continue, the determinacy thesis must accurately reflect social reality, because otherwise we would already have slipped into the war of all against all of the Dark Ages.

The second response to the recognition of the significance of power within social relations is to accept its presence, but to deny that it is necessarily present. Thus many non-liberals depict law as already the domain of power. According to this critical perspective, legal doctrine merely represents manipulation by an empowered elite furthering its own interests under the guise of a rights discourse.\textsuperscript{223} To these critical theorists, the determinacy thesis serves the ideological purpose of masking the reality of the illegitimacy of judicial power. 'To study ideology', John B Thompson suggests in a different context, 'is to study the ways in which meaning (or signification) serves to sustain relations of domination.'\textsuperscript{224} According to such critiques of legal doctrine, the illegitimate exercise of power in adjudication must be eliminated as part of a more wideranging reform of the political community which seeks to reinstate the autonomy of the rational subject as the foundation of legitimate government.

The third response to the recognition of a necessary role for power in adjudication is to embrace it, in various ways, as an inevitable part of social

\begin{footnotes}
\item[221] John Locke, 'Second Treatise of Government' in J Locke, \textit{Two Treatises of Government} (1988) para 211, 403; Thomas Hobbes, \textit{Leviathan} (1968) 227; Dworkin rejects the notion of consent, but in practical terms it is difficult to differentiate the 'protestantism' of his 'true community' of willing subjects from one founded upon consent; see: Dworkin, above n 1, ch 6. For an examination of the modern theorisation of power as founded upon consent see: B Hindess, \textit{Discourses of Power: from Hobbes to Foucault} (1996).
\item[222] See, for example, Altman, above n 1.
\end{footnotes}
discourse. This third option is clearly anathema to proponents of the first two approaches to the role of power in discourse. Understandably, those who pursue social reform often query whether everything is an effect of power:

What is there 'left over', so to speak, to find this situation so appalling? What, including one Michel Foucault could conceivably protest against this condition, given that all subjectivity is merely the effect of power in the first place? If there is nothing beyond power, then there is nothing that is being blocked, categorized and regimented, and therefore absolutely no need to worry. Foucault does indeed speak of resistances to power; but what exactly is doing the resisting is an enigma his work does not manage to dispel.\textsuperscript{225}

Non-liberals therefore worry about the postmodern scepticism about truth and rights,\textsuperscript{226} perhaps understandably seeing a rights discourse as a central plank in a program of furthering the interests of disadvantaged peoples:

I worry about criticising rights and legal language just when they have become available to people who had previously lacked access to them. I worry about those who have, telling those who do not, 'you do not need it, you should not want it.'\textsuperscript{227}

There are therefore a number of significant contemporary discourses aligned against the postulate of the inevitability of power in adjudication. Such discourses either perceive power as an illegitimate component of adjudication where it is not founded upon the consent of autonomous, rational subjects or, without explicitly adopting this liberal denunciation of power, are fearful of the consequences of embracing power in social theory. The question therefore arises of how a non-liberal legal theory can simultaneously account for the phenomenology of determinacy, explain the fact that we have not succumbed to

\textsuperscript{225} Terry Eagleton, \textit{Ideology: an introduction} (1991) 47.
\textsuperscript{226} See, for example, S Scheingold, \textit{The Politics of Rights: Lawyers, Public Policy and Political Change} (1974) (arguing that liberal legal theory is founded upon the myth of rights).
the Hobbesian spectre of the war of all against all, deny the validity of an ideal adjudication bereft of illegitimate power and still provide some hope for those who wish to offer a critique of the status quo without being told in Baudrillardian fashion, that ‘we don’t debate things in these here parts because rationalism has been run out of town.’

But the depiction of power as avoidable, which underpins the first two responses to power, has not been the only model for the exercise of power within Western social theory. In a theorisation of power similar in many respects to antecedent critical theory and even one branch of Locke’s deliberations upon power, Foucault argued that there is a need to ‘cut off the King’s head’ by acknowledging the diversity and ubiquity of power within any community. In various degrees and forms, power is exercised by everybody within a community: total subjugation can therefore only rarely exist. Thus, Foucault challenged the universality of the ideal underpinning much critical social theory, arguing that such an ideal is merely one effect of power. One reading of Foucault would therefore suggest that social power is a much broader, multifaceted phenomenon than what Hindess has called the ‘simple minded determinism’ of a concept of power as a mere ability to control others. On this view, power can not only control but be a means of creation:

If power were never anything but repressive, if it never did anything but to say no, do you really think one would be brought to obey it? What makes power hold good, what makes it accepted, is simply the fact that it doesn’t only weigh on us as a force that says no, but that it traverses

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228 See, for example, Jean Baudrillard, *Forget Foucault* (1987).
229 For a discussion of which see: Hindess, above n 221, 17-22, 145-6.
232 Hindess, above n 221, 141.
and produces things, it induces pleasure, forms knowledge, produces discourse. 233

Foucault is therefore not concerned with the legitimation of power in particular instances, but rather merely with describing the effects of power in localised discourses.

Eagleton’s concern that the recognition of a role for power in all social discourse eliminates any prospect for critique of alternative world views is founded upon a ‘quantitative’ 234 conception of power which assumes that social relations arise from confrontations of power in which the person or group with the most power subjugate(s) the other(s). Under this quantitative theory of power, the issue is whether the power is being legitimately exercised or not; legitimacy generally being conceived in terms of the consent of autonomous rational subjects. At times Foucault lent support to this quantitative conception of power, particularly when he wrote of power at the macro level:

A central phenomenon in the history of societies is that they manifest in a massive and universalizing form, at the level of the whole social body, the locking together of power relations with relations of strategy and the results proceeding from their interaction. 235

The theory of interpretation advanced in this chapter denies that such totalising power can exist, a view consistent with the former conception of Foucault’s


234 For a discussion of differing conceptions of power within Western social theory see Hindess, above n 221.

work which emphasised the localised nature of power.\(^{236}\) This is not to suggest that at times the exercise of power in the quantitative sense will not be all too apparent - the suppression of dissenting interpretations in the political arena by bloody means is all too frequent. However, the point of this chapter is that the survival of any interpretation cannot be achieved by force alone.

3 The Combination of Power with Rhetoric

Some sense of the complexity introduced into any account of adjudication by this recognition of both a bifurcation of concepts of power and the acceptance of a diffusion of power throughout the community may be gleaned from Douglas Hay’s account of the administration of the criminal law in the United Kingdom during the eighteenth century.\(^{237}\) Hay’s thesis is that the successful administration of the criminal law in a time of great social foment was not solely dependent upon the crushing weight of state authority, but was largely attributable to what would often be called ‘extra-legal factors’ such as the paternalism of the ruling classes. The law could be brutally applied when need be, but it was not brute force alone which served to maintain order in a community with a largely ineffective criminal administration. In other words, order was maintained as much by the willing compliance of the ‘oppressed’ as by the imposition of state authority.

Hay’s work suggests that members of a community may often feel that an interpretation is determinate and even, perhaps, ‘right’, notwithstanding that such an interpretation runs contrary to the perceived interests of those members. But it is the contention of this chapter that the dynamism of the politics of identity dictates that any such conclusion can only be a tentative, contingent

\(^{236}\) See, for example: Michel Foucault, ‘Omnes et singulatim: towards a criticism of “Political Reason”’ in S McMurrin (ed), The Tanner Lectures on Human Values (1981), 223-254, 226; Michel Foucault, ‘What is Enlightenment’ in Rabinow, above n 233, 32-50, 45.

position founded upon the individual's interpretations of the arguments in favour of competing interpretations. Such a position is subject to review at any time in response to alternative arguments for an alternative interpretation. For any meaning to arise and survive in the contingent world portrayed by the politics of identity, there must be sufficient support for a particular interpretation for it to be accepted as 'right'. The task of any advocate of an interpretation is therefore to frame the interpretation in such a manner that it garners sufficient support from whatever portion of the community that may critically review the interpretation. In the absence of any universalising or hermeneutic standpoint from which truth may be assessed, the rhetorical art of persuasion is clearly critical to the success of any interpretation.

In this regard Rorty's concept of warrants of authority is apposite. However, rather than adopting Rorty's portrayal of warrants of authority having a standing accepted by all members of the community, it is proposed that the arguments in support of a particular interpretation will need to appeal to a diverse array of warrants of authority, acceptable from the perspective of differing standpoints, in order to muster sufficient support within a community. 238 By raising alternative arguments in support of a particular interpretation, the interpreter gathers together members of the community in support of one interpretation, even though the supporters might agree on nothing else. 239 Beginning from different standpoints does not necessarily produce a different result upon a particular issue of interpretation. The persuasiveness of any interpretation may be influenced by any or all of a host of principles, including what Posner called

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238 In his discussion of ideology Eagleton suggests that it is the heterogeneity of the dominant ideology which enables it to survive, a view which is consistent with my theory of interpretation; Eagleton, above n 225, 45.

239 Even Marx and Engels recognised the importance to the success of a revolutionary class of this rhetorical task of garnering support by appealing to disparate classes; Karl Marx and Friedrich Engels, The German Ideology, CJ Arthur (ed), (1974), 66; for a discussion of this universalising aspect of emergent ideology see: Eagleton, above n 225, 56ff.
the maximisation of wealth,\textsuperscript{240} consideration of past decisions, arguments from particular moral principles, argument by analogy and even the universalising rhetoric of determinacy.\textsuperscript{241} The identification of meaning must therefore be a rhetorical process in which an interpreter seeks to win the support of sufficient peers and commentators so as to minimise the risk of criticism or other adverse reaction.\textsuperscript{242} Moreover, publication of alternative ideas might not be tolerated, compelling the decision maker to frame the grounds for a decision in terms acceptable to substantial elements of the reviewing community.\textsuperscript{243}

Within such a model there can be no question that the decision maker is merely identifying what social morality requires, or what the interests of some undefined social class dictate.\textsuperscript{244} There can therefore be no suggestion that this theory allows 'us' to settle back on the sofa with a self satisfied smile, relaxed in the knowledge that:

Our identification with our community - our society, our political tradition, our intellectual heritage - is heightened when we see this community as ours rather than nature's, \textit{shaped} rather than \textit{found}, one among many which men have made.\textsuperscript{245}

This reassurance is not available to us because there is not one society which we can call 'ours'.\textsuperscript{246} All that we may have is a multiplicity of coalitions of interest

\textsuperscript{241} Fish, above n 72, 141-179.
\textsuperscript{243} For which I have drawn upon Rorty's concept of warranted assertibility, see text accompanying n 220. For application of this concept in the domain of the philosophy of science, see, for example, M Jacob, 'Science and Politics in the Late Twentieth Century', in \textit{The Politics of Western Science 1640-1990} (1992) 1-19, 4.
\textsuperscript{244} But cf Horwitz, above n 159.
\textsuperscript{245} Rorty, \textit{Consequences of Pragmatism}, above n 31, 166.
\textsuperscript{246} As Raymond Williams noted, hegemonic ideology must always be responsive to the dynamism of alternative ideologies; Raymond Williams, \textit{Marxism and Literature} (1977) 112.
groups prepared to accept various premises but not others, various arguments but not others, various interpretations but not others, across the gamut of political issues. Any such coalition is liable to change in response to changes within such coalitions elsewhere in the wider community.\textsuperscript{247} Nowhere is there an equilibrium which affords anybody the opportunity to rest on their laurels.\textsuperscript{248} A proponent of an interpretation is constantly striving to win and maintain allies in a dynamic world. An argument is only as good as the support which it is able to muster from the wider social context of which it is a part.\textsuperscript{249} As with Hoy's critical pluralism, then, this theory embraces pluralism and is sceptical of the prospects of achieving 'the truth'.

\textbf{G Conclusion}

By accepting that all knowledge is 'grounded' in some social context, contemporary determinacy theorists have conceded that all knowledge is to some extent pragmatic. But once pragmatism is thus admitted past the portals of liberal legal theory, it wreaks havoc from within upon attempts to theorise legal determinacy. Both psychoanalytic theory and multicultural theory, which stress the plurality of the personal and social lifeworld respectively, offer a sound foundation for questioning the liberal belief in a monovalent, homogeneous community which serves to constrain what is accepted to be the

\textsuperscript{247} 'Discourses must be treated as discontinuous practices, which cross each other, are sometimes juxtaposed with one another, but can just as well exclude or be aware of each other.' Michel Foucault, 'Is it Useless to Revolt?' (1981) 8 Philosophy and Social Criticism 1. But cf Horwitz, above n 159; whilst a critique of Horwitz's work is beyond the scope of this paper, the pluralist social theory tendered here is clearly inconsistent with Horwitz's thesis. Horwitz argues that American law adapted mechanically to the demands of an ascendant 'commercial interest.' Thus he charts the demise of substantive judicial decisionmaking and the rise of legal formalism. The 'oppressed' may also have had an interest in the apparent objectification of the law, as it may have enabled them to adopt the rhetoric of rights rather than being confronted with the reality of judicial discretion exercised by a biased judge; see further: EP Thompson, above n 233. What Horwitz seems to assume is that the law successfully picked a winner in forming a strategic alliance with the commercial interest. But the 'commercial interest' could not exist without the host of legal relations which constituted it as a prominent interest.

\textsuperscript{248} Contra Gadamer, Reason in the Age of Science, above n 92, 108-9.
pragmatic process of interpretation. Unless contemporary liberal theory can develop an account of legal determinacy which incorporates an acknowledgement of this politics of identity, it is difficult to see how the liberal determinacy thesis can be considered anything other than a view of law through rose tinted spectacles. It is in this context that Habermas’ work is significant - he was prepared to accept the pluralism of the politics of identity and sought to develop a theory of determinacy in a pluralist lifeworld. Habermas’ work therefore points the way for future developments within liberal legal theory. But as we have seen, Habermas’ unconvincing attempt to overcome the anarchic effects of a pluralist world suggests that present and future liberal legalists confront a daunting, and arguably impossible, task.

In rejecting the various liberal and non-liberal accounts of the determinacy thesis, I am mindful of the ‘political’ implications of such a conclusion. As noted at the outset of this chapter, if it were convincing, the determinacy thesis might be a reassuring account of how a ‘civilised’ society can entrench the rule of law as a bulwark against arbitrary exercises of ‘quantitative’ power. For this reason it is not only liberals who support the determinacy thesis as a fundamental aspect of modern democratic society. It is therefore not surprising to find that a theory of interpretive determinacy is adopted by some on the political left, who also advance a theory of social transformation towards a ‘better’ society, because such transformative theories also depend upon the identification of the ‘right’ transformative path. To those advancing such theories of social transformation, the indeterminacy thesis can all too easily lead to a fatalistic acceptance of ‘what will be will be’. There is certainly some merit in the concern, expressed by Norris and Eagleton, that to reject accounts of legal determinacy without replacing them with an alternative amounts to no more than the adoption of what they perceive to be a conservative, stable status

249 Such an approach is therefore incompatible with a strong relativism, which accepts that each argument is as good as any other.
Indeed, this conservative endorsement of the status quo is all too apparent in the postmodernist work of Fish and Rorty.

In the latter part of this chapter I have argued that an endorsement of an indeterminacy thesis need not entail the conservative depiction of a world in which dissenting voices are lost in 'our' 'frankly ethnocentric' worldview or in the prevailing interpretation of 'the' legal community. If the indeterminacy thesis is to be taken seriously, as I have argued, I cannot validly argue for one 'right' theory of interpretation, one 'right' interpretation or even one 'right' program of social reform. Nor can I validly argue for a critical pluralism, a description of a theory which is oxymoronic if the pluralist aspect is taken seriously. In a sense the argument advanced in this chapter therefore fatalistically accepts that there is nothing to be done but acquiesce in the status quo. But whereas Norris, Eagleton, Rorty and Fish all generally perceive the status quo to be a static world dominated by the conservative influence of liberal theory, the argument of this chapter is that the lifeworld is much more dynamic, such that no one world view necessarily holds sway. Indeed, taking the domain of liberal legal theory, one purpose of this chapter has been to illustrate the fact that the liberal idea of legal determinacy is itself the subject of competing interpretations. The argument advanced in the latter part of this chapter would suggest that the willingness of many social and legal theorists to suppress such dynamism in favour of a 'stable' status quo is itself but a rhetorical device.

To the liberal legalist worried about the breakdown of social order should the determinacy thesis be jettisoned, and to the transformative theorist who believes that s/he is 'outside' the present legal system, I therefore say the same thing - we are already a fractured part of a fractured community in which we are all constantly seeking to gather supporters to our respective views. This account of

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250 See, for example: C Norris, Reclaiming Truth: contribution to a critique of cultural relativism (1996).
the rhetoric of legal theory and legal interpretation is therefore neither a normative theory nor a conservative theory.

This theory of law as rhetoric is also significant for legal history. According to contemporary liberal legal theory, the analysis of earlier legal interpretations would entail an account of how judges and administrators had generally reflected the morality of their community in making an interpretation, and would perhaps also identify those interpretations which were 'wrong' according to the prevailing standards of the community at the time of the decision. By contrast, the theory of law as rhetoric in a pluralist world asks 'how was it that this legal doctrine came to be accepted as right - what rhetorical devices enhanced the appeal of this doctrine in a multifarious community?' In answering this question, the diversity within our pluralist world must be embraced in offering a wideranging interpretation of the operation of the plurality that is law within a pluralist society. At this point it is therefore appropriate to return to the accounts of the interpretation of tax legislation in the preceding chapters, and consider the relevance of this theory to those accounts, and also to consider the implications of this theory for the modern tax administration.

251 This conclusion is therefore consistent with the critique of American historiography by Horwitz; Morton Horwitz, 'The Conservative Tradition in the Writing of American Legal History' (1973) 17 American Journal of Legal History 275.
CHAPTER SEVEN - CONCLUSION

There can be no doubt that the determinacy of law constitutes a major discourse within modern Anglo-Australian jurisprudence, and for good reason. The certainty of the law portrayed by various liberal legal theories is an alluring prospect to liberals and many non liberals alike. To liberals, a legal system in which subjects prospectively know how the law will apply to their affairs, or at least a system in which subjects know that they can seek an impartial and non arbitrary adjudication upon their legal rights, is a quantum leap from the arbitrary administration of government during the 'Dark Ages'.\(^1\) To many legalists, the certainty of law is fundamental to both the centrality of law in modern society and the professionalisation of legal service providers. To adapt Stanley Fish’s phrase, many of us want the law to have a formal existence because such formalism also offers both a reassuring account of the operation of a fundamental social institution and offers hope to those seeking social reform. However, it is clear from the preceding chapters that this most appealing account of determinate law fails both descriptively and normatively.

Although the generally accepted account of tax interpretation since 1689 portrays the application of determinate law in accordance with the literal meaning or legislative intention, the preceding chapters suggest that the interpretation of taxation law is indelibly stamped with judicial pragmatism. Whereas the generally accepted account of statutory interpretation posits a judicial choice between lawmaking and the discovery of law, the pragmatic theory of law advanced in this thesis rejects the existence of this choice by maintaining that adjudication is inevitably a creative process. To many ‘modern’ judges, this conclusion may seem unremarkable, as they may point to

\(^1\) A metaphor which figures prominently in the Whig interpretation of history which underpins liberal legal theory. For a general critique of the Whig interpretation of history, and discussion of the ‘Dark Ages’ metaphor, see: Herbert Butterfield, \textit{The Whig Interpretation of History} (1965) 28-9.
their numerous public acknowledgments of their 'lawmaking' role. Indeed, while he was the Chief Justice of the High Court of Australia, Sir Anthony Mason observed that:

In Australia we have moved away from the declaratory theory and the doctrine of legalism to a species of legal realism. Appellate courts no longer articulate principles of law by reference exclusively to inductive and analogical reasoning from established rules of law. Judges take account of relevant policy considerations (for principles of law ultimately rest on underlying considerations of policy) and they have an eye to the practical consequences of the rules they apply and the decisions they make.²

However, this modern recognition of judicial activism is flawed on two counts. Firstly, such pragmatic theories of law suggest that this 'judicial activism' is undertaken within the context of the constraint of one guiding maxim,³ one homogeneous communal morality⁴ or a legal institution which governs the scope of judicial pragmatism.⁵ However, it has been argued that a recognition of social pluralism and the politics of identity requires a rejection of such homogenising interpretations of legal practice. Once it is accepted that such pluralism defines the very nature of the human condition, the prospect of a critical standpoint transcending this pluralism must be rejected. Accordingly, adjudication upon meaning must be theorised in terms of a pragmatic choice between competing interpretations engendered by alternative standpoints in a multicultural lifeworld. This is not to say that competing interpretations ought be conceptualised in terms of static entities which crash into each other in a manner akin to some 'last one standing' crash and bash derby. Competing

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⁴ Ronald Dworkin, Law's Empire (1986).
interpretations may freely assume some rhetorical aspects of another interpretation in an ongoing discursive interplay which is fundamentally rhetorical. Swayed by often quite disparate discourses, judges have adopted the interpretation with the strongest rhetorical appeal assessed from their particular standpoint. Thus, at times the importance of accommodating business understandings of legislative terms has been recognised, at other times the perceived need to protect the government revenue, on some occasions the significance of the 'rule of law' has been stressed, while at other times the courts have accepted the rhetoric of legalism in resolutely maintaining that they must adopt the 'technical' legal meaning of legislative terms. Little has changed since the times of the window tax, when the courts accepted the rhetoric of national exigency in construing the window tax legislation in favour of the Crown.

The second shortcoming of the account of judicial activism is that it reinforces the liberal legal history of the law by accepting that judges once discovered the law and could have continued to discover the law were it not for their collective choice to embark upon a path of judicial activism. The preceding chapters illustrate the weakness of this account. Once granted jurisdiction to hear window tax appeals, the eighteenth century courts in fact rejected a literalist approach and adhered to the maxim of interpreting the window tax legislation in favour of the Crown without regard to literal meanings. If anything, the eighteenth century courts interpreted the window tax legislation pragmatically, influenced by the perceived imperative of buttressing what was considered to be a weak central government threatened by war, internal dissent and fiscal crisis. After the courts were granted jurisdiction to hear income tax appeals in the last quarter of the nineteenth century, the judicial appeals to a literalist methodology

5Stanley Fish, Doing What Comes Naturally: Change, Rhetoric and the Practice of Theory in Literary and Legal Studies (1989); Stanley Fish, There's No Such Thing as Free Speech and it's a good thing too (1994).
belied a thoroughgoing judicial pragmatism in the interpretation of tax legislation. Grappling with legislation which could be interpreted in any number of ways from the standpoints of a multiplicity of competing discourses, the courts were compelled to choose from among any number of competing interpretations in what was ultimately an act of power rather than a discovery of ‘the law’. Even during the first sixty years of the Commonwealth income tax, in what is often portrayed as the highpoint of literalism, it is apparent that the interpretation of tax legislation was anything but literalist. Once again, the Australian courts confronted tax legislation which could be interpreted in any number of ways from the respective standpoints of competing discourses. Although there was often no overt reference to such competing discourses, the exercise of judicial discretion in the framing of what was perceived by the judge to be a ‘just’ income tax may nevertheless be discerned in the interpretation of the ‘sufficient distribution’ requirement, despite the frequent recourse to the rhetoric of literalism. The literalism to which the courts referred was therefore a myth. There was no acontextual or conventionally determined meaning of the statutory language, but rather always a fresh choice to be made from among competing interpretations born of rhetorical discourses vying for supremacy. Even after the rhetorical shift to a purposive interpretation in the 1980’s, the courts continued to confront an array of competing interpretations of Part IVA, framed from alternative standpoints. Again, the choice between those competing interpretations was not expressly or impliedly guided by the discovery of the one legislative intention, but rather constituted an exercise of judicial discretion.

But as Dworkin notes,⁶ one critical question confronts the theorisation of law as a pragmatic institution depicted in this thesis. How can the disorder within the field of taxation law, portrayed by this pragmatic theory of interpretation, have been contained by the discourse of legal determinacy and liberal legalism for so
long? Has there been a monumental confidence trick perpetrated by the courts?\(^7\)

In an explanation consistent with the theory of adjudication developed in this thesis, the answer lies with the ability of those promoting the discourse of liberal legalism to garner sufficient support and subdue competing theories of law. Perhaps this manner of stating the reply suggests that the promotion of liberal legalism and the determinacy thesis is necessarily a conscious choice undertaken by individuals within the community after having surveyed the rival theories. Occasionally it may have been. In a recent discussion with one serving Federal Court judge I asked whether he thought judges made law. ‘Of course we do’ was the reply. I then asked why it was that there was no reference to this lawmaking function in any of the judges decisions. ‘Because we wouldn’t get away with it’, he replied. Occasionally judges have been prepared to make similar statements for the public record:

> Personally, I think that judges will serve the public interest better if they keep quiet about their legislative function. No doubt they will discreetly contribute to changes in the law, because ... they cannot do otherwise, even if they would. The judge who shows his hand, who advertises what he is about, may indeed show that he is a strong spirit, unfettered by the past; but I doubt very much whether he is not doing more harm to general confidence in the law as a constant, safe in the hands of the judges, than he is doing good to the law’s credit as a set of rules nicely attuned to the sentiments of the day.\(^8\)

But it is not necessarily the case that all judges consciously engage in such deception. Indeed, it is more likely that the determinacy thesis and liberal legalism are widely perceived as the ‘natural’ way of understanding the modern Australian legal institution. ‘Natural’ because it draws upon a number of rhetorically appealing discourses. Many want the law to have a formal

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\(^6\) Dworkin, above n 4, 46-7.


\(^8\) Lord Radcliffe, ‘The Lawyer and his Times’ in Not in Feather Beds (1968) 265; see also: Lord Edmund-Davies, ‘Judicial Activism’ (1975) 28 Current Legal Problems 1, 3.

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existence because of the fear of the anarchy and arbitrariness which it is thought would flow from acknowledging pragmatic theories of law. Legal formalism is also appealing because it is considered to be fundamental to principles of democracy embodied in the doctrine of the separation of the judicial from the political power\textsuperscript{9} and the faith in the rational discovery of objective facts which is one key characteristic of modernism. Thus, judges may not be consciously choosing to adopt theories of interpretation consistent with the determinacy thesis in preference to pragmatic theories. Rather, judges may simply adopt the rhetoric of legal determinacy because it seems more 'natural' or more appropriate than the contenders. It is for this reason that judges regularly refer to literalism and intentionalism as if they are the one right method of interpretation, because for that particular judge who holds that view objectivism describes the one right way of understanding judicial practice.

However, notwithstanding this repeated judicial preference for the determinacy thesis, the preceding discussion of the interpretation of tax law suggests that the interpretation of taxation law has been and must be pragmatic in a most radical sense. The act of judging represents an exercise of power which is only constrained by the limits of what can be cast as plausible in any number of ways at the time.\textsuperscript{10} To many this will be an unsatisfactory conclusion. It cannot be doubted that the prospect of a formal law is alluring, and it is for this reason that many would prefer this thesis to conclude with some proposals for reforming the legal system to bring it closer to the ideal of formality. However, this would be to misunderstand the import of this thesis. Once it is accepted that legal formality is a forlorn hope, it is irrational to cling to the formalist ideal because that ideal is unachievable. The only conclusion of this thesis can be to point to

\textsuperscript{9} Although the separation of powers is not a sufficient condition for the existence of democracy.
\textsuperscript{10} \textit{Contra} PS Atiyah, 'Judges and Policy' (1980) 15 \textit{Israel Law Review} 346, 346 ('Nobody would deny that in a considerable proportion of cases which come before a judge for decision, the law is clear').
some implications of the pragmatic account of interpretation outlined in the preceding chapters, and highlight those matters requiring further research.

From the preceding case studies it is clear that there is much work to be done in reconsidering the history of tax interpretation. The dominance of the prevailing account of literalist tax interpretation has meant that the interrelationship of interpretative practice and the social context in which interpretation of tax legislation is conducted has been largely ignored. Legal historians have expected to find a historical record which reflects judicial decisionmaking in accordance with the constraints of legal formality, and have seemingly ceased further inquiry once they have found the odd judicial statement which supports that conclusion. Even when tax interpretation has been considered from a critical perspective, such research has generally only compared the judicial interpretation of a particular matter to an alternative answer founded upon what is assumed to be a universal alternative standpoint. The conclusion of such critical appraisals of the judicial interpretation of the income tax is generally founded upon some determinist theory of law in which judges respond to a narrowly defined context governed by the interests of a ruling elite. As with the literature sustaining the formalist theory of tax interpretation, the interaction of the standpoint of the judge(s) deciding the relevant cases and the social context in which those cases are decided is ignored or viewed narrowly in the quest to validate the commentator's a priori assumption(s). The questions which are ignored in all of these accounts is 'why did the result seem right to the judge - what made it the 'natural' conclusion?' What voices were excluded? Why was it 'natural' for the judge to exclude those voices? How could the judge maintain the legitimacy of the courts while excluding those voices.

12 See the material referred to above at n 3.
Answering these questions will compel a consideration not only of the social context in which the decision is being made, but also a close reading of the judgment in order to identify those discourses which were considered to justify the erasure of plurality which lead to the conclusion.

The second implication of this thesis is the need to re-examine the legitimacy of the courts in the context of the administration of taxation law. At present the debate within mainstream Australian jurisprudence with respect to the legitimacy of the courts centres upon the identification of the most appropriate path to what is assumed to be a determinate outcome that is portrayed as morally right. As we have seen, many espouse the view that judges merely discover the literal meaning or the legislative intention, while some suggest that judges make law in accordance with the community’s moral norms. Both accept that there is a choice between law as it is and lawmaking in some sense, and develop their theories of legitimacy accordingly.

Those that advocate the judicial discovery of law according to the literal meaning or the legislative intention of the legislative text maintain that the legitimacy of the courts is founded upon the prospectivity of law. To this group, the onus is upon the legislature to create legislation which accurately expresses the correct moral outcome. This group therefore remain optimistic that the legislative text can express what is taken to be ‘morally’ right in determinate language.

Those that champion judicial ‘lawmaking’ are less optimistic about the capacity of language itself to convey a determinate meaning. This group therefore maintains that the legitimacy of the courts depends upon the identification of a ‘right’ outcome, which is ‘right’ because it reflects communal expectations rather than reflecting the meaning that is intrinsically in the text.

Both theorisations accept that there is one right answer but disagree upon the path to that right answer. This competition between competing theorisations of
the proper scope of judicial practice in the context of taxation law was considered by McBarnet and Whelan, who suggested that the fundamental tension within modern law is the conflict between formalism and anti formalism: McBarnet and Whelan then conclude that there is insurmountable resistance to an anti formal means of arriving at the 'right' answer. In arriving at this conclusion, McBarnet and Whelan assume that the control of tax avoidance is universally 'right', although nowhere do they acknowledge the problematic nature of the tax avoidance concept and hence the problematic character of the universal standpoint which they assume. From the discussion of tax interpretation in the preceding chapters, it may be seen that the existence of one right outcome is always problematic when consideration of the optimal tax system is located within the plethora of competing discourses extant within any community. In other words, if anti formalism or indeterminacy is taken seriously, judges can never be morally or legally 'right' because there can never be agreement upon the ideal, 'right' outcome in a pluralist lifeworld devoid of the universalising standpoint sought by critical monists such as Habermas. The pragmatic theory of law advanced in this thesis therefore calls for a reconsideration of the legitimacy of the courts, and in particular the constitutional doctrines of the rule of law and the separation of powers which underpin the alternative theorisations of judicial legitimacy outlined here. If the judges are not discovering and applying law which is in some way determinate, and have no prospect of doing so, should the courts retain any role in the tax administration?

In his non legalist theory of tax administration Grbich and others have argued that the function of the courts ought be restricted to that of enforcing due process, leaving the determination of substantive tax issues to the Australian Taxation Office. Grbich’s proposal is founded upon what he considers to be the pragmatic need to eliminate tax avoidance by vesting broad discretions in the tax office. However, it may be doubted whether entrenching the Commissioner of Taxation as judge in his own cause, by effectively eliminating any substantive role for the courts, will achieve the effect that Grbich desires. It is generally accepted that any tax system depends for its success upon voluntary compliance, and that voluntary compliance is in turn dependent upon the perceived fairness of the system. The perception of fairness of the tax system is dependent upon the perceptions of the substantive law, and also the perceptions of the process by which that law is enforced. With respect to the latter, the displacement of the judiciary by the executive arm of government in relation to tax disputes could be expected to have a deleterious impact upon the perception of the fairness of the tax system, even if a pragmatic theory of interpretation advanced in this thesis were generally accepted. This is because the pragmatic theory of interpretation advanced here, and the interpretation of tax legislation according to the imperatives of the state, are not necessarily synonymous. A pragmatic judge may quite reasonably find the perceived need to protect the citizen from ‘unfair’ taxation laws to be of greater rhetorical appeal than enhancing the revenue of the state in a particular case. The point is that the perceived independence of the judiciary remains an important aspect to the rationalisation of the legitimacy of the courts, even if a pragmatic theory of


interpretation is adopted. There is therefore good reason to retain the role of the courts, notwithstanding the endorsement of a pragmatic theory of interpretation.

If the courts are to remain a viable part of the tax administration, how would a judge pragmatically interpret the legislation in a world where the portrayal of determinate law is no longer adopted? If there is no right legal answer or standpoint from which a judgment may be assessed, how can we know whether the courts deserve to be considered legitimate on the basis that they are independent? What is to stop a judge from deciding cases according to a reading of tarot cards, or an observation of shooting stars, or the size of 'the Chancellors foot' as the common lawyers used to disparagingly observe regarding the resolution of disputes in Chancery? In the past, judges were inevitably pragmatic, but at least the judges could maintain their claims to legitimacy by more or less convincing recourse to the concept of legal formality. Clearly, under a pragmatic theory of interpretation the facade of formalism must be dispelled. However, the recognition of pragmatic adjudication does not necessarily equate with arbitrary adjudication, the judiciary will only retain their claim to legitimacy for as long as they are able to sustain the belief in the community that a judge is an independent adjudicator committed to resolving disputes according to a plausible account of justice. It would therefore still be necessary for a judge to give a detailed statement of reasons which would be susceptible to close scrutiny along the lines noted above. Under the pragmatic theory of law advanced here, very little would change in the process of judging. The judge would remain a rhetorician who must demonstrate the plausibility of any decision by recourse to any number of discourses. Judges always have been, and always will be, rhetoricians who have only retained their legitimacy by this process.

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16 PS Atiyah, ‘Judges and Policy’ (1980) 15 Israel Law Review 346 (arguing that the law is inevitably pragmatic in at least a good proportion of cases, and, albeit reluctantly, considering the implications of the open acknowledgment of the lawmaking aspect of the judicial function).
A further implication of the recognition of the rhetorical nature of adjudication in the context of the income tax is that it would be necessary to reconsider the nature and function of legislation and the legislative process. At present the Commonwealth Government is engaged in a massive project directed at simplifying the tax legislation. This project was founded upon the view that tax legislation ought prospectively declare in clear terms how a person’s tax liability might be ascertained.\(^\text{17}\) In doing so, the Parliamentary Committee collapsed what had previously been thought to be a binary opposition - legislative precision and legislative simplicity. It had formerly been repeated that the more the legislature strove for detailed elaboration of the income tax base in the name of certainty, the more complex the legislation would be.\(^\text{18}\) Nevertheless, adopting the rhetoric of simple English and literal interpretation, it was proposed that the legislation could be rewritten in order to fulfil these goals.\(^\text{19}\)

However, a key contention of this thesis is that the discovery of the plain meaning of legislation or the legislative intention envisaged in this model of tax reform is a forlorn ambition. No matter how detailed the legislation becomes, there will always be room for the courts to interpret the legislation in any number of plausible ways. If the legislation is expressed more briefly in ‘plain English’, on the basis that the detailed elaboration of the extent of the legislative scope is impossible and that the legislature may safely make numerous assumptions, once again the court may choose from among any number of competing plausible interpretations borne of alternative interpretative standpoints. This scepticism with respect to the prospects of the tax simplification process raises a number of issues concerning the legislative


\(^{18}\) To others, the simplification of the income tax system is only achievable by substantive income tax reform. These commentators suggest that the legislature must clearly express its purpose by adopting a cohesive income principle framed upon the economic concept of income, and then legislating for specific exemptions; see: Krever, above n 11.
process. If judges do not discover statutory meaning in the legislative text, is it farcical to suggest that Parliament ought labour over proposed legislation and debate the minutiae of the bill in the belief that the meaning will be fixed when the bill is passed into law? Does a pragmatic theory of legal interpretation as rhetoric mean that a legislature wanting to impose a tax upon 'wealth' might just as well express itself in terms of imposing a tax upon 'elephants', given that the judges will make of it what they will? In other words, does the recognition of a pragmatic theory of interpretation plunge the community into an anarchic morass?

Once again it must be emphasised that adjudication upon tax legislation has always been pragmatic, and that in many important respects nothing would change if the exercise of judicial power was generally accepted to be pragmatic. In interpreting the window tax, judges willingly accepted that coal chutes were a 'window', in interpreting 'profits and gains' judges of the Victorian era excluded the economic concept of profits promoted by contemporary economists and in the interpretation of the sufficient distribution requirement the courts at times rejected the 'literal' meaning of the provision in favour of an alternative interpretation. Such judgments illustrate the rhetorical aspect of adjudication. Judges retained their legitimacy by presenting solutions which at least appeared plausible according to one or more discursive standpoints with sufficient weight within their community. The recognition of the rhetorical aspect of adjudication therefore locates any legislation within a multidimensional matrix of overlapping and competing discursive fields with which the legislation itself interacts in a dialectic way. Legislation is a part of the context in which the legislative text is interpreted and itself contributes to the maintenance of the discursive standpoints from which it is interpreted.

In 1915 the Commonwealth Government responded to what I have called the discourse of the welfare state in part by including a progressive rate scale within the income tax. In a small but nevertheless significant way this strengthened the
claim of the welfare state discourse which in turn was accorded greater discursive weight in debates regarding the interpretation not only of other aspects of the income tax legislation, but other legislation overall. Shortly after, in 1922, the Government moved to impose some limits upon the Commissioner’s discretion under the sufficient distribution requirement. This reform responded to the calls for reform primarily from the standpoint of the rule of law discourse, and in turn readjusted the weighting within the discursive matrix in favour of that discourse and to the detriment of the discourse of tax equity engendered by the discourse of the welfare state. The point of these examples is that, once it is recognised that the legislative text is a response to and impacts upon its social context, the legislative text ceases to be conceived in terms of a formal endpoint and is reconfigured as a point on a continuum in which legislative meaning is created, recreated and recreated again. In a sense, then, a legislature wishing to tax ‘wealth’ might express itself in terms of taxing ‘elephants’, and the judiciary might very well interpret this tax upon ‘elephants’ as a tax upon wealth if the discursive fields into which this new tax is introduced support the conclusion that such an interpretation is plausible. After all, since Saussure it has been recognised that the naming of a thing is a purely arbitrary affair, and so a community (or at least a substantial part of a community) which is prepared to accept as plausible an interpretation which holds that a tax upon ‘elephants’ is a tax upon ‘wealth’ is free to manufacture this new meaning for ‘elephant’.

Conceptualising legislation as a point on a continuum of the creation of meaning rather than an endpoint necessarily entails a considerable degree of scepticism regarding the prospects for success of the current income tax simplification project. It will never be possible for the legislative process to achieve the determinacy of meaning envisaged at the inception of the tax simplification
project. Nevertheless, the tax simplification project may make a substantial contribution to the development of the income tax legislation in several ways deserving of further research.

Firstly, the tax simplification project may make a significant contribution to the discursive matrix in which the tax legislation is interpreted by developing some discourses at the expense of others. For example, in a rebuff to the discourse of purposive interpretation of legislation sustained by ss15AA -AD of the Acts Interpretation Act 1901 (Cth) and the decision in Cooper Brookes, the emphasis upon the plain and simple meaning of the legislation may be expected to lend additional authority to the literalist discourse by emphasising the validity of interpreting legislation on its terms. Further, in recognition of the concern for the rule of law posed by the expansion of administrative discretion, and in a rebuff to those that have argued for broad administrative discretions in the fight against what is perceived as tax avoidance, one of the objectives of the simplification project is to reduce the number of administrative discretions. Finally, a pragmatic theory of interpretation is consistent with the proposition that there is a difference between writing which is readable and writing which has determinate meaning. Although a pragmatic theory of interpretation suggests that the objective of producing determinate law must be viewed with considerable scepticism, it may well be that the simplification project will make a substantial contribution to the accessibility of the legislation and thereby promote wider debate upon its meaning to the community. In many respects, then, the recognition of a pragmatic theory of interpretation would entail little practical change from the interpretative practice adopted by


21 For a discussion of tax simplification in terms of the readability of income tax legislation see: James and Lewis, above n 18.
the courts for the past three hundred years. If anything, it might be expected that a recognition of the pragmatism of the judicial interpretation of tax legislation will foster a closer scrutiny of tax decisions, rather than the simplistic characterisation of judgments according to the various versions of the determinacy thesis.
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